INSURANCE AGENT COMMISSION DEREGULATION

HEARING

BEFORE THE

SUBCOMMITTEE ON GENERAL OVERSIGHT

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

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CONTENTS

	Page
Hearing held on September 21, 1981	1
Opening statements of:	
LaFalce, Hon. John J., chairman, Subcommittee on General Oversight	1
Marriott, Hon. Dan, a Representative in Congress from the State of Utah.	3
Testimony of:	
Albus, William N., associate general counsel, National Association of Life Underwriters	75
Bowers, Gordon M., C.L.U., Discount Insurance Service, Inc., Richmond, Va	42
Burstein, Meyer Louis, economist, York University, Toronto, Canada	31
Mitchell, Susan, Wisconsin commissioner of insurance	4
Nader, Ralph	20
Regan, John D., C.L.U., president, Regan Co., San Francisco, Calif	40
Scheel, William, professor of finance and insurance, University of Connecticut—Storrs	57
Steinbach, E. Stony, CAE, executive secretary, Professional Insurance Agents of Wisconsin, on behalf of National Association of Professional Insurance Agents	85
Vogel, Julius, senior vice president and chief actuary, Prudential Insurance Co., and Robert S. Seiler, senior vice president and general counsel, Allstate Life Insurance Co., on behalf of the American Council of Life Insurance	81
Additional material supplied for the hearing record:	
Albus, William N., associate general counsel, National Association of Life Underwriters: Prepared statement	79
Bowers, Gordon M., C.L.U., Discount Insurance Service, Inc., Richmond, Va.: Illustration of potential savings	44
LaFalce, Hon. John J., chairman, Subcommittee on General Oversight:	
Article—Property and liability insurance in a "net pricing" framework	69
Article—Proposal to repeal antirebate law stirs emotional outcry in Wisconsin	66
Miscellaneous statements for insertion in the hearing record	92
Nader, Ralph:	
Advisory statement by Attorney General Bellotti of Massachusetts	26
Appendix A—Competition in price for service in insurance	23
Scheel, William, professor of finance and insurance, University of Connecticut—Storrs: Tables—Potential insurance rebate activity	64
Steinbach, E. Stony, CAE, executive secretary, Professional Insurance Agents of Wisconsin, on behalf of National Association of Professional Insurance Agents: Prepared statement	88

INSURANCE AGENT COMMISSION DEREGULATION

MONDAY, SEPTEMBER 21, 1981

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GENERAL OVERSIGHT,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:40 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN LAFALCE

Mr. LAFALCE. The subcommittee on General Oversight will come to order.

Strong opinion has developed across the United States to decrease the role of the Federal Government in business activities so that the economy can react to normal market forces. The turn of the century and the 1930's were times of economic upheaval, when measures were taken to insure market stability with little regard for their impact upon the principles of free enterprise. The 1980's and the decades ahead are a different time, with vastly different institutions and problems. It seems to me now is the time to rid the economy of inflation-causing, anticompetitive market restrictions.

Our hearing this morning will examine what may very well be one of the most costly and enduring price-fixing schemes ever perpetrated upon the American public.

For nearly 75 years, American consumers and many small businesses have been denied any opportunity to negotiate the amount of an insurance agent's commission with either the insurer's agents or any independent agent who might handle the same policy. Notwithstanding the fact that there is undoubtedly a substantial variance in overhead costs and levels of efficiency among the agents, the insurance statutes in all 50 States require that each and every one of those agents must charge precisely the same commission as every other agent for a particular policy.

Conceived during a period of intense agent competition at the turn of the century, these statutes, generally referred to as antidiscount or antirebate laws, were designed in large part to insulate the insurance industry from excessive agent competition. It is a testament to the massive power of the insurance industry that this form of monopoly pricing has gone unchallenged for three-quarters of a century.

Last week I introduced an anti-inflationary measure to repeal that portion of the McCarran-Ferguson Act which has for far too

long permitted the insurance industry to engage in massive price-fixing of agent commissions outside the scope of Federal antitrust law. Entitled "The Insurance Sales Deregulation Act," when enacted, my bill will finally put an end to the insurance industry's version of the now defunct and discredited fair trade laws. My bill is supported by the National Insurance Consumer Organization, the Consumer Federation of America, and SBANE, one of the most active and highly respected small business organizations in the country.

It is estimated that Americans paid more than $190 billion in life, health, and property and casualty insurance premiums in 1980. Contrasted with the fact that they paid $240 billion in Federal personal income taxes for 1980, you can begin to realize the economic leverage possessed by this industry. And yet, as a result of anachronistic Government restrictions we continue to absolutely prohibit our hundreds of thousands of insurance agents—250,000 life insurance agents alone—from competing for business on the basis of reduced or discounted commission fees.

Consider for a moment the following case: A small businessman 53 years of age wishes to purchase a whole life key man policy for $153,000. The policy he chooses has an annual premium of $5,350. Through business associates, he is aware that the agent's commission will be approximately 90 percent of the first year's premium or $4,800—agent's commissions generally range from 90 to 120 percent of the first year premium, with a 5-percent renewal fee for each year the premium is paid thereafter.

Yet, regardless of whether he seeks to negotiate his purchase with the company's agents or through independent agents, the policy price, which includes both the cost of the insurance and a fixed commission for the agent, will be exactly the same.

Any price competition among agents has been effectively eliminated by the antidiscount laws in all 50 States. If any of these agents had been a doctor, a lawyer, a grocer, an accountant, or a securities broker, he would have been able to sell his services at any price, since price competition is an essential feature of the American free enterprise system. In fact, if any of the members of these occupations were detected charging uniform, identical prices, they might soon find themselves involved in antitrust litigation.

The McCarran-Ferguson Act is a dangerously permissive statute. For nearly 40 years it has allowed States to enact one insurance law after another that would otherwise be in violation of Federal antitrust statutes. The result has been a Federal umbrella for monopoly price-fixing by the insurance industry through State laws. I propose that we begin the task of amending that umbrella and thus nullify the State laws that prohibit insurance agents and brokers from engaging in competitive pricing of commission levels. I propose that we get the Federal Government out of the retail insurance marketplace and in its place permit competition to establish rates rather than restrictive private agreements between insurers and agents.

The potential for savings to American consumers and small businesses from this act of deregulation is awesome. Even if we assume a very conservative savings of only 3 percent arising from agent competition on insurance premiums of $190 billion, we still arrive

at annual cost savings of $5 to $6 billion to the American public. It is worth noting that the 1977 Justice Department report on regulatory reform included reference to an estimate by an insurance agent trade association that savings to consumers resulting from commission deregulation would amount to a maximum of 6 to 7 percent on premiums. I am sure most would agree that such a savings would not be inconsequential.

Certainly we are all in agreement that our economy must be made less prone to inflation and more responsive to anti-inflationary policies. Congress has a particular responsibility to see to the elimination of phony Government-supported barriers to price decline.

In that regard, we must ask why the retail sale of insurance has remained immune from such basic elements of our economic system as price competition and free market forces. Clearly the time has arrived for the Congress to scrutinize this artificial support for the American insurance marketing system.

I am confident that the Congress in its deliberations will come to the same conclusions arrived at by a 1977 Department of Justice task group on antitrust immunities created by President Ford. In the course of their report on the insurance industry, the task group reviewed each of the arguments offered by the insurance industry to justify the continuation of the antidiscount laws in all 50 States. The task group created by President Ford convincingly refuted each argument in turn.

We will have an opportunity today to listen to various representatives of the insurance industry claim that it is to the advantage of the Nation's insurance consumers to rely on artificial Government pricing restrictions rather than the forces of a free and open marketplace.

It is, indeed, a delicious irony that an industry which professes to believe in unfettered free enterprise can arrange to come down on the side of severely restrictive Government regulation when it happens to suit their interests.

The consumer, the businessman, and the country are all best served by a dynamic and competitive system of marketing. True competition will force insurers, agents and brokers to provide the insurance consumer with the most for his money.

The repeal of the antidiscount laws will stimulate an increase in productive efficiency which in turn will lead to lower prices, greater disclosure, and lessened inflationary pressure in this vital sector of our economy.

We have no other members of the subcommittee here but a member of the full committee; we are fortunate to have Congressman Dan Marriott who brings considerable expertise to this issue because of his past incarnation as an insurance salesman.

Dan?

OPENING STATEMENT OF HON. DAN MARRIOTT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH

Mr. MARRIOTT. Thank you, Mr. Chairman.

I suppose as a guest of this subcommittee one would expect me to be rather timid on this subject and sit back and listen to the chairman.

I won't be able to do that.

I personally think, Mr. Chairman, that you have been advised by some misinformed and misguided staff in terms of taking on the insurance industry and I doubt most of them know anything about the industry or why the commission schedules are set up as they are.

I would only hope, Mr. Chairman, that the good tooth fairy might swoop down with his magic wand and touch your head and you might reconsider getting involved in State issues.

I think this, in fact, is a State issue.

The McCarran-Ferguson Act leaves the administration of insurance to the States. I think the Federal Government has no business getting into it. If the States want to provide some type of a rebate policy, then they can certainly do that.

I don't think the Federal Government needs to get involved. So I would hope that this bill, H.R. 4497, might go the way of all bad bills and that we might spend our time on more constructive matters.

Nevertheless, Mr. Chairman, I appreciate being here. I look forward to hearing the witnesses who are going to enlighten us on why the life insurance agents are making too much money, and I would hope they might also discuss the legal fees and the other fees being perpetrated upon society while they are discussing insurance commissions.

I look forward to hearing these testimonies.

Thank you, Mr. Chairman, for inviting me down to take part.

Mr. LAFALCE. Well, I thank you for your comments, Dan.

I would now call upon Susan Mitchell, the commissioner of the State of Wisconsin Department of Insurance.

I hope, Ms. Mitchell, in your comments you will take up the challenge and compare other professions such as the legal profession, to see if we have any laws on the books which prohibit them from engaging in discount or rebates and the same with accountants and, I think, every other profession on the face of this Earth.

TESTIMONY OF SUSAN MITCHELL, WISCONSIN COMMISSIONER OF INSURANCE

Ms. MITCHELL. Thank you, Mr. Chairman.

I am here to speak in support of H.R. 4497. This bill would achieve the same result as a bill introduced at my request in the Wisconsin Legislature last January.

Essentially, Mr. Chairman, you and I have a common goal: To permit more price competition in the sale of insurance.

Currently the laws of every State prevent the seller of insurance—the agent—from reducing the price of the product to the buyer. These laws—commonly known as the antirebate laws—hurt consumers because they impede price competition. In some cases they actually provide an incentive to an agent to sell consumers a higher priced product than the consumer needs.

Your proposal and mine would eliminate the antirebate laws that stand in the way of price competition by the agent for the buyer.

Both proposals would give consumers the opportunity to benefit from the fundamental principle underlying the American econo-

my—the principle of open competition. We in government have a responsibility to try to eliminate laws that actually prevent price competition.

Currently the price of insurance is set by the insurance company. The company establishes the cost of the pure insurance protection and also sets the markup, or the commission paid to the agent who sells the product. State laws prevent the agent from reducing the size of the commission.

This means that agents who may be able to market insurance more efficiently are prevented by State law from passing on any savings, or commission reductions, to consumers.

But, repealing the statute would do more than permit rebates. It also would permit price reductions.

It would permit fee for service arrangements. It would permit agents to offer different fees based on the extent or variety of services provided. In other words, it would permit—but not require—alternative marketing systems.

This is a rather simple idea to reduce regulation and increase competition.

It is a new and rather threatening idea to the insurance industry. It is not new, however, to the majority of American business where price competition is the necessary incentive for efficient production and the principal safeguard for cost conscious consumers.

Nor is it new, however, to Congress or to other regulated industries where similar deregulation proposals have led to price reductions.

The repeal by Congress of the fair trade laws in the mid-1970's is one example. Those laws required retailers to sell certain products at the price listed by the manufacturer.

Prior to repeal, a toaster purchased at a discount store cost the same as a toaster purchased at a fancy department store. After repeal, a toaster purchased at the discount store cost less—obviously because the discounter had the freedom to pass on as savings lower costs of doing business.

I might forewarn you that my use of this analogy has prompted reports that I want agents to provide their customers with toasters. I have actually received letters from agents inquiring as to how they can maintain ther professionalism when their offices are full of toasters.

I have not suggested that. While I do not believe that Government should prevent an agent from engaging in such a harmless activity, I believe most buyers are interested in price reductions and not gifts.

Another analogy is deregulation of stockbrokers' commissions, which were set at a fixed rate until 1975. Contrary to the fear of many stockbrokers, the new system has produced benefits for consumers without the adverse impact predicted by so many in the industry.

Since repeal, discount brokerage firms have offered reductions in commission rates up to 80 percent. Despite the concerns of some brokers, however, the discounters have taken only a small share of the market.

The majority of investors continue to be served by full service brokerage firms. Many of these firms have changed their pricing structure to set specific charges for various services. Investors who formerly were charged a flat commission now have the option of selecting the services for which they wish to pay.

In the field of insurance, the proposal before you would have the greatest impact on the sale of life insurance.

The current marketing structure for life insurance is an expensive one. It is characterized by what economists call reverse competition—a characterization, by the way, with which many life insurance officials agree.

Here's how that works. Companies compete for agents, not buyers of their products, on the basis of the size of the commissions they offer. A survey of the policies filed with my office shows that first-year commissions are as high as 120 percent of the premium.

The advertisements for agents illustrate the competition for agents. They seek to attract agents with high flying commissions and promises to agents that they will get commissions faster, longer.

Clearly the current system puts consumers at a disadvantage. An agent will naturally lean toward selling for a company that offers higher commissions. And when an agent has a choice of products to sell, he or she has an incentive to sell a product that earns a large commission.

The current system also encourages the replacement of existing policies because the agent who sells the new policy earns the high first-year commission. Replacement makes sense in some circumstances and not in others. However, if the commission is a major motive for the replacement, the advice given the consumer may not be in his or her best interest. I believe the day will come when both agents and companies will recognize that the commission structure does not necessarily serve their best interests because it does not reflect the actual cost of doing business. An agent may earn a $500 commission on a sale that requires three calls on a client and several additional hours of work. The next day the same agent may earn a $500 commission with only 1 hour's work. The commission simply does not reflect his or her actual expenses.

This problem has surfaced during my discussions with a number of very professional life agents in Wisconsin. They have indicated to me that they would like to charge a fee in addition to a commission on certain types of business, a practice currently forbidden under Wisconsin law. In these cases, the actual cost of selling exceeds their commission and they need more money to show a profit.

I am sympathetic. I am simply asking them to apply the same standard in the opposite case. If they can sell a product and make a profit by charging less than the commission they receive, the State should not stand in the way of a price reduction. In other words, the freedom to raise prices to cover the cost of doing business should be accompanied by the freedom to lower prices as well.

There is another reason why these anticompetitive statutes should be repealed: They are ineffectual and unenforceable. Let me read you the language of the Wisconsin law:

S. 628.34(2) No insurer, no employe of an insurer, and no insurance intermediary may seek to induce any person to enter into an insurance contract or to terminate an existing insurance contract by offering benefits not specified in the policy, nor may any insurer make any agreement of insurance that is not clearly expressed in the policy to be issued * * *.

This has been construed primarily as a prohibition of rebates. But what is an unfair inducement? Suppose an agent takes a client to lunch and pays the bill. Suppose the agent takes the client on a golf outing and pays the fees. Suppose the agent gives the client a calculator or a calendar. Are those unfair inducements? Those are all common business practices, of course, but technically they could be construed as violations of the law.

That puts the regulator in the role—unwanted, in my case—of social arbiter. Agents literally call my office to ask whether certain gifts to their prospective clients would be violations of the law. We are in these instances offering the public protection they don't need.

In 1962 two well-known experts on insurance law discussed the subject of rebating in a Columbia Law Review article. They concluded that the statute is rarely enforced.

I quote from their article:

It is difficult to estimate with any degree of confidence the extent to which rebates exist in the insurance world. Persons who commit the offense of rebating are not anxious to discuss it, and, since no one is harmed directly, the violation comes to light only in those cases in which a third person stumbles upon evidence or one of the parties admits his guilt.

If the number of rebating cases investigated and prosecuted by the various insurance departments provided an accurate measure of the extent of the offense, we would have to conclude that rebating rarely occurs. In all the States surveyed, we found only a handful of investigations of agents for alleged rebating although occasionally we found a rather important one. Moreover, we found few prosecutions, fewer convictions, and almost no application of sanctions.

Let me give you an actual example of how these laws affect buyers of insurance.

A company based in Milwaukee wanted to buy key man insurance and sought bids from two major insurers. The commission on the sale amounted to about $40,000. That was a cost clearly higher than the actual expense of the sale so the Milwaukee firm attempted to negotiate the commission.

The two insurers involved refused to provide any discount. So the Milwaukee firm licensed one of its employees as an insurance agent. The agent-employee then agreed with the agent of one of the insurers to split the commission and paid his share of the commission to his firm.

Thus the Milwaukee firm, after considerable effort, was able to reduce the cost of its insurance by circumventing a law, as one financial journal put it, that prevents capitalism between consenting adults.

The history of the antirebate statutes deserves some attention because, as is the case with many laws—the circumstances that led to their passage no longer exist.

The first antirebate statute was passed in the late 1800's by New York; the other States followed suit.

The proposals were one of a list of recommendations resulting from the Armstrong investigation of life insurance company practices.

The investigation was called primarily because of the then unregulated financial practices of the largest insurers. These companies were offering deferred dividend policies, under which a person who lived for a period of time specified in the policy—5, 10, or 15 years—would be paid a dividend at the end of that time. A person who died before the specified period ended received the face amount of the policy but no dividend.

The companies did not account for these dividends on an annual basis. In other words, they did not set aside money to pay these future liabilities until the year the dividend was due. That permitted them to use money which should have been set aside to pay higher and higher commissions. As agents received higher commissions without a need to render more service, they used the excess money to buy sales by offering rebates.

The public's tolerance of these practices ended when the companies were unable to pay dividends in the amount they had projected.

In this atmosphere, the Armstrong committee recommendations were readily accepted. The major change required companies to account for dividends on an annual basis. The recommendation that rebates be prohibited was secondary to the major changes proposed by the Armstrong committee.

In fact, according to one account, the prohibition against rebates was debated by the committee and survived only by a narrow margin.

The factors that led to the passage of the antirebate laws no longer exist. Life insurers are far more strictly regulated in terms of the protections they must offer policyholders. The need for the antirebate statutes—if there ever was one—has disappeared.

You will hear today from the insurance industry a variety of reasons why the antirebate statutes should be kept in place. I would like to try to answer some of these arguments in advance.

First. If agents are permitted to rebate, unscrupulous companies and agents will take advantage of unsuspecting buyers by offering large rebates.

The insurance industry is the only business I know where the word "rebate" has a nasty connotation. Most industries consider rebates competitive sales tools.

People who buy commodities or services rarely buy based on price alone. People who buy insurance will consider a premium discount but they will also consider service, reputation of the company and agent and the characteristics of the product.

Second. Rebates will give the sophisticated buyer an advantage over the uninformed buyer and will result in unfair discrimination.

In any marketplace, the sophisticated buyer has an advantage over the uninformed buyer. Under insurance law, price discrimination is prohibited when it is not based on the nature and degree of risk or expenses. Consequently, agents who offer discounts must do so in a manner that treats consumers fairly.

Third. These proposals will drive the small agent out of business and hurt the new agent by giving an unfair advantage to larger agents.

Current regulations may be artificially supporting more agents than are needed. If there is an oversupply of agents, there may be

some reduction. However, if there is enough business to go around at the rates being charged, new agents and small agencies will have no problem.

Fourth. Agents will become less professional if they are forced to compete with rebates.

Remember, elimination of these laws opens the door to new methods of pricing. Many professionals charge hourly fees. Some charge specific fees for specific services; the customer chooses the service he or she wants.

Fifth. Agents will demand higher commissions from companies so that they can offer higher rebates. The price of insurance will go up because people will buy from the agent who offers the highest rebate. This argument lacks logic.

Let's say that a Cadillac dealer selling a $25,000 car offers a $5,000 rebate; the net cost of the Cadillac is $20,000.

Let's say that a Ford dealer selling a $12,000 car offers a $2,000 rebate; the net cost of the Ford is $10,000.

Does anyone seriously believe that a car buyer will purchase a $20,000 Cadillac instead of a $10,000 Ford simply because the rebate is larger? A buyer will look at the bottom line.

The people who argue that these laws should be retained will offer these and other arguments. Buyers may be misled and may make unwise buying decisions under a competitive pricing system. That is true whether we are buying new tires or choosing a stockbroker, or buying insurance.

The current system puts insurance buyers at a greater disadvantage: The high commission policies that benefit the agent are not necessarily the policies of greatest value to the buyer.

The buyer, and ultimately the industry, will benefit from a change.

Thank you. I would be happy to answer any of your questions.

Mr. LAFALCE. Thank you very much, Ms. Mitchell. I want to compliment you on your fine statement. Even more so, I want to compliment you on your pioneering efforts. You really are the first insurance commissioner to break into this new territory.

Actually it was your proposal in the State of Wisconsin which first brought this problem to my attention. It is also my understanding that you have not yet been able to have a legislative hearing in Wisconsin, although that might be forthcoming in the future?

Ms. MITCHELL. Yes; I have not asked for a hearing on the bill. I suspect we will have one sometime in the fall.

Mr. LAFALCE. Good. I am glad we are able to air it here in Washington, D.C.

Congressman Marriott is quite correct that the Federal legislative body has been loath to go into the field of insurance in this century, especially since the McCarran-Ferguson Act.

I don't think it is going to be the easiest thing in the world to do despite what I perceive as the absolute logic behind it.

At the very least, perhaps these Washington hearings will bring some attention to the issue, not just in the State of Wisconsin, but in all 50 of the States.

Let me ask you a few questions.

We have had—we will be having some testimony later today from representatives of the insurance industry, a number of them, and they are all claiming in their written statements that the result of regulating—of deregulating commissions will mean that the average insurance consumer will be required to pay higher prices.

Would you care to comment on that?

Ms. MITCHELL. I think this is based on the assumption that I raised in my last argument, that agents will demand higher commissions in order to give consumers higher rebates. I think that that argument fails to look at the fact that the consumer is ultimately going to look at the final cost of the product in addition to the reputation of the agent, the service provided, and the other characteristics of the product.

I don't think people will buy simply because somebody offers them $500 instead of $300 if the final cost of the product and the ongoing cost of the product is higher.

Mr. LAFALCE. This is beyond the scope of this hearing perhaps, but this brings to my mind the importance of the issue of disclosure.

Would you care to tell me how important you think the issue of disclosure is when it comes to insurance policies, insurance agents' commissions, and so forth, and what the general state of the laws on the books in the 50 States are with respect to disclosure?

Ms. MITCHELL. Yes. I think the issue of life insurance cost disclosure is important with or without this proposal. It is an issue that has gained considerable attention from the National Association of Insurance Commissioners.

Currently the NAIC model is, in effect, in perhaps 22, 23 States. I might be slightly off on that number.

In Wisconsin I attempted to change the disclosure system and offer a new alternative, but was blocked by a suit and lost in the Wisconsin Supreme Court.

The relevance of cost disclosure to this issue is a significant question because the current systems would need to be changed, but I would hasten to point out that the NAIC regulation now in effect in nearly half the States is already outdated and the reason that it is outdated is that the indices, two of the indices that are used, assume a fixed rate of interest in the accumulation of cash value in a policy.

What has happened in the past 2 years—even more than 2 years—in the life insurance industry has been very dramatic.

The products have changed considerably, mainly because of high inflation. There are new products now that offer money market rates on the cash value portion of the so-called traditional whole life policy and that blows apart the old disclosure system.

The old indices do not accommodate that kind of product. In fact, that even came up in the trial 2 years ago vis-a-vis my proposed system.

The Aetna, one of the plaintiffs in the trial, argued that the current cost disclosure indices would not be suitable for their Econo-master policy which has variable aspects to it.

So I think that the NAIC is going to have to relook at the whole issue of life cost disclosure. It is an issue that will not go away.

As long as the internal benefits of a policy are not reflected in the premium, people need help in measuring those benefits. That is, in a nutshell, what cost disclosure systems have tried to do.

Mr. LAFALCE. Ms. Mitchell, do the model disclosure suggestions of NAIC call for commission disclosures?

Ms. MITCHELL. No.

Mr. LAFALCE. So if commission disclosures aren't called for, even if there is compliance with NAIC recommendations, that is a substantial portion of the premium, is it not?

Ms. MITCHELL. The commission explicitly is not disclosed, although in certain respects the formula would take into account commission as part of the expense.

I personally have never favored the notion of disclosing commissions per se. I do not think we see this in other forms of retailing. You don't ask them to disclose their fees, although you might on an individual basis ask your lawyer what he is going to charge; that sort of thing.

I think if the marketplace is allowed to become truly competitive, that that issue will take care of itself.

There is an additional value in this sort of proposal in terms of people being able to understand the cost of the products that they may be buying.

To the extent that, say, a group like Consumer Reports would be able to do cost comparisons of insurance products net of commission, or net of any markup, a person might say, aha, this policy that Prudential offers costs this much net.

Now I will shop around and see who will charge what to sell it to me; so there may be an advantage in that respect that promotes better price comparison.

Mr. LAFALCE. Does the present commission structure favor one form of life insurance over another?

Ms. MITCHELL. Yes; it does. I think that has been well known for years.

Mr. LAFALCE. Could you explain how and why that is?

Ms. MITCHELL. The commission structure on the traditional whole life policy is typically considerably higher than the commission on a term policy.

Term tends to be lower cost insurance anyway because it is pure insurance protection. It does not have any other internal benefits typically. There are some exceptions to that.

So if you take 30 percent of the term commission, you will have a considerably lower dollar amount than if you take 60 or 70 percent of a whole life commission. That naturally is an incentive for agents to sell whole life insurance which may not be bad, but the incentive is there to offer to the consumer a policy that earns the agent a higher commission.

There was a study done in 1977 by an agent's group——

Mr. LAFALCE. Is there usually then a lower percentage commission offered to an agent when he sells a term and a higher percentage offered to an agent when he sells a whole life?

Ms. MITCHELL. Typically that is true. In fact, that was the particular——

Mr. LAFALCE. Normally speaking, what percentage ranges might we be talking about?

Ms. MITCHELL. I am not able to calculate an average in my office. The analysts who review the life policy filings think that the average term commission is around 30 percent and the average whole life commission is around 60 or 70 percent.

Mr. LAFALCE. You are talking first year?

Ms. MITCHELL. Of first year premium.

The renewals would drop considerably, perhaps to 15, 20 percent in the years following purchase.

That is the reason, incidentally, in my testimony——

Mr. LAFALCE. Does that 60 percent whole life include what is known as the general share?

Ms. MITCHELL. I am not certain I follow that question.

Mr. LAFALCE. The general agents? Would that therefore bring it up to a higher percentage? Perhaps 90?

Ms. MITCHELL. That varies, depending upon a company's marketing structure, what percentage they are going to pay to general agents and the others in the structure, going down.

I haven't been able to average any of those figures because we don't collect the right data, but the point I wanted to make was that the agents who came in to talk to me about this proposal—and we have had several very long discussions—said to me at that point when we sell a term policy there are often indications where the sale of term is better, for a younger buyer with not a lot of income, perhaps an unskilled spouse, and young children, that person probably ought to spend all of their insurance dollars on a term policy.

I have seen specific instances of that.

What the agents are telling me is, we cannot make enough money. It literally—the commission literally does not cover the cost of the sale.

May we also charge a fee in addition to that commission?

I have a separate bill in that would permit agents to charge a commission and a fee, and that bill, I might add, will pass in October.

Mr. LAFALCE. Thank you very much.

I have a number of other questions, but let me recognize Congressman Marriott.

Mr. MARRIOTT. Thank you, Ms. Mitchell. You are the insurance commissioner?

Ms. MITCHELL. That is correct.

Mr. MARRIOTT. For Wisconsin?

How do your fellow insurance commissioners feel about your initiatives?

Ms. MITCHELL. A handful of them—I haven't taken any polls—I have discussed it with a number of them.

Some of them have indicated that they would like to raise the issue in the next session. Most of them do not want to raise it as far as I know right now.

Mr. MARRIOTT. Hasn't this issue been raised before over the years and fallen upon deaf ears?

Ms. MITCHELL. As far as I can tell—and I suspect I have one of the best files in the country on this issue right now—the major discussion took place in the early 1900's around the Armstrong investigation.

I haven't been able to find any other evidence that it was thoroughly discussed.

Mr. MARRIOTT. I am curious about one thing, and that is, why you are making comparisons among toasters, automobiles, and life insurance policies.

Do you really think there are no differences among the three? I am talking about the way the policies are structured.

Normally I guess on a toaster, an automobile, what you see is what you get, and you get some warranties for a couple of years. So, it is pretty easy to make a decision whether you like red, green, blue or other particular features.

But a life insurance policy, in my opinion, is a rather complicated animal, very easily used to deceive people.

Do you think really there are no differences? Can you really make the analogy that we ought to sell life insurance policies like we sell toasters?

Ms. MITCHELL. I think the analogy I was trying to make was the classical economic analogy of whether or not the producer of the product should be permitted to set the pure price of the product and the markup.

That is a system foreign to other kinds of American businesses, but to go to your point of insurance being a complex product, life insurance, in particular, is, especially compared to personal lines, auto, and homeowners where the policies, as you know, are much more standardized.

It is very difficult for people right now to choose the right product, and it is even more difficult, given the fact that agents have an incentive to sell a higher priced product.

Perhaps a better analogy than toasters, cars, or something that is a durable good, is the analogy of going to a tax lawyer. You pick a tax lawyer by reputation and then you go to that person and you find out what the fees are going to be, and you go up front whether or not that person is going—what sort of hourly rate that person is going to charge, whether or not that person is going to use other persons in the law firm to do additional services, and just what you are paying for.

But, like insurance, it is a very difficult service to purchase with any guarantee of the outcome of the quality of advice you are going to get.

I think there are many analogies in the professions where fees are not regulated. Accountants, doctors, dentists, an so forth.

Mr. MARRIOTT. Let me ask you this: Do you think there are differences in life insurance policies in terms of quality, in terms of benefits? For example—and how does that relate to the premium being charged?

My understanding is that on most ordinary life policies, if you are in New York, for example, your commission is limited to about 55 percent. It isn't 100 percent or 120 percent. Most life insurance policies have a commission that ranges from 55 to maybe 90 percent when all the smoke clears. Term insurance may be from 30 to 70 based on the company.

But don't you believe, as the insurance commissioner of Wisconsin, having looked at thousands of policies, I take it, that there is,

87-363 O - 82 - 2

in fact, a difference in the product of a policy that pays 100 percent commission or 90 percent, and one that pays 55 or 60 percent?

Ms. MITCHELL. Oh, there is substantial difference in the quality of the products.

My point in proposing this is that, given the fact that I assume what you are suggesting is the products that bear very high commission may be more costly to consumers, is that it?

Mr. MARRIOTT. I would simply say this: If my memory serves me right, a life insurance premium throws off several benefits.

It throws off a pure cost of term insurance; it throws off dividends, casual use, paid-up life insurance, extended term insurance, and all the rest.

If I go sell a policy and get a 90-percent commission, it is probably likely I will have none of those four other side benefits for maybe 2 or 3 years whereas if I buy a policy with a 50-percent commission or maybe 55 percent, I may in fact, have first-year casual use, may have 2 or 3 years of extended term insurance, paid-up insurance, and so forth.

Now, if we are just coming down saying let's allow rebating, what is going to happen in my opinion is that no one is going to be looking at those parts of the policy.

I am talking about the general public, not the sophisticated insurance buyer. So we are going to buy policies on which we can get the biggest rebate and, in the long run, wind up with inferior products.

Is that not a possibility if we do what you suggest?

Ms. MITCHELL. I don't believe that it is in the majority of cases.

I believe the scenario that you just described points precisely to the problem that we have right now. If you are correct, that a policy with a very high first year commission suffers in terms of the other benefits it offers people, and if I am correct and the agent's study is correct that shows that nearly half the agents sell policies with the highest commission, then consumers are being very ill-served by the current structure.

Mr. MARRIOTT. Do you have some studies to show what percent of the insurance agents work for New York companies?

Ms. MITCHELL. No. I could probably find that figure. I don't have that right now.

Mr. MARRIOTT. Do you have any studies at all to show what percent of the agents are paid on various commission scales?

When I was in the business, I didn't find too many agents making 90 percent, unless they were selling for some very unknown, inferior companies, if I can use that term loosely.

But isn't it true that there is a difference in products?

Ms. MITCHELL. Oh, there certainly is.

Mr. MARRIOTT. And the commission schedule somehow is related to the product?

Ms. MITCHELL. It may bear no relationship to the quality of the product.

Mr. MARRIOTT. What do you mean it doesn't? If there is a difference in first-year casual use, extended term insurance, paid-up values, and so forth, why doesn't it have a bearing?

Ms. MITCHELL. To the extent that to the policyholder, let's say you are talking about a $500 first-year premium. The policyholder

confronted, or the prospective buyer confronted with two agents has no idea whether the commission on that is 90 percent or 10 percent and is in no position under the current market structure to judge which is the best policy.

Mr. MARRIOTT. Absolutely. So if one agent offers a 90-percent rebate or a 50-percent rebate and the other offers a 10 percent rebate, who is going to get the business?

Ms. MITCHELL. Well, you are assuming two level policies in the same competitive position and you are assuming that the person doesn't look at anything else.

Obviously——

Mr. MARRIOTT. Do you think he does?

Ms. MITCHELL. Yes.

Mr. MARRIOTT. Do you think most of the insurance buyers look at all the fine print of a policy?

Ms. MITCHELL. Well, you were arguing earlier that insurance is a very complex product. I ask you, do you go to a doctor and look just at the price?

Mr. MARRIOTT. Do I ever have a choice at the doctor's office as to what the price is?

I went to my friendly attorney last week and I wanted a document made up. In fact I had two different attorneys working on two different documents.

Here they are. They are charging me by the hour. They are not saying our fee will be $4,000. They are charging by the hour.

Ms. MITCHELL. That is correct.

Mr. MARRIOTT. I guess one wasn't as bright as the other, and he put in a lot more hours. I had one bill for $5,000 and one for $1,900 on two different documents, both about the same.

Now, do we want to get into that issue?

Ms. MITCHELL. No. There is no law, Congressman, that prohibits one attorney from charging less than another attorney. That is the issue before us.

Mr. MARRIOTT. Let me ask you this question.

Mr. LAFALCE. I am afraid——

Mr. MARRIOTT. May I have 1 more minute?

Mr. LAFALCE. Certainly.

Mr. MARRIOTT. I really think you are missing some of the points here. I don't mean to get into attorneys and all of that, but no one is taking them to court or asking any laws to be made or not to be made in reducing legal fees.

Maybe it isn't related to this.

We may be getting off the track. Let me ask you one more question even though I don't think my questions have been answered.

Would you be in favor of eliminating commissions from policies altogether?

In other words, let the life insurance company put out a pure product free of any commission, servicing fees, or whatever; and then let whoever wants to sell that product attach his own fees to it.

Ms. MITCHELL. Yes.

Mr. MARRIOTT. Do you think anybody will benefit from that?

Ms. MITCHELL. Yes.

Mr. MARRIOTT. Who?

Ms. MITCHELL. I think the marketplace will produce a range of services just as it has in the securities industry where, for example, you might find sophisticated buyers going to insurance discounters, people who felt as though they didn't need advice.

You might also find people doing what the full service brokerage firms are doing now, which is, offering a variety of services and saying, if you just want me to execute this trade, it will cost you x dollars.

If you also want my research service, it will cost you x dollars, and you might find other people offering fee-for-service arrangements.

If it costs the agent 2 or 3 hours of work to sell a product and analyze the person's financial needs, the agent would be able to charge for that, whereas if the agent only needed 1 hour to do that, the person buying the service in that case wouldn't pay the same as the first buyer.

That seems to me to make ultimate sense.

Mr. MARRIOTT. Let me just conclude by asking this: Wouldn't that be a better approach, if you are really serious about your proposal, than messing with rebates? It doesn't seem to me it would be subject to as much abuse.

If you simply required insurance companies to write a pure product and then let the agents and brokers determine their own fees to do it, it would be better than trying to fiddle with rebates, wouldn't it?

Ms. MITCHELL. I understand your point. I think one of the difficulties that the industry has in addressing this proposal—and it is a very natural difficulty—is that they tend to view this statute as the antirebate statute where, in fact, if you look at the wording of the statute, it talks about unfair inducements.

It really prohibits any of those other things from happening. I really do get agents calling and saying, well, this Christmas I would like to give away a $5 calculator, am I going to get in trouble with your office.

Mr. MARRIOTT. Finally, I know my time is up, but I can hardly stand it without this last question: Doesn't your State allow you to eliminate the rebate rules now?

Couldn't the Wisconsin Legislature deal with this issue?

Ms. MITCHELL. Oh, yes. I have a bill before me.

Mr. MARRIOTT. So you don't need Federal legislation to overturn McCarran-Ferguson? Your State legislature could buy your arguments and allow rebating in the State of Wisconsin?

Ms. MITCHELL. That is correct.

Mr. MARRIOTT. Thank you.

Mr. LAFALCE. Dan and I agree on that last point.

Wisconsin could so act. I hope they do. I hope they do shortly.

I hope the other 49 States would do so quickly also, but that may not be the case. Perhaps these Federal hearings can help the process along, help the inquiry along.

Just a few points. Dan has mentioned the legal profession so often and in my prior incarnation I was an attorney.

I happen to think there are too many attorneys in the United States, but when I was an attorney I had the pleasure of represent-

ing a tremendous number of insurance companies. I find them very, very honorable institutions.

One of the great steps forward, it seems to me, Dan mentioned attorneys aren't taken into court, was when attorneys were taken into court. There was a restrictive law on the books that attorneys couldn't advertise, and that law was taken to the Supreme Court of the United States and the Supreme Court of the United States said no, no, that is unconstitutional; we better permit advertising.

I just wanted to mention that as a point of interest.

Now, to go back to the relevant issue, it seems to me there is a refrain here that higher commissions will result in better products in greater consumer benefits.

Would you care to comment on that?

Ms. MITCHELL. I am not certain that I am understanding your question correctly.

Mr. LAFALCE. It seems to me there is a thread in the opposition to the proposals that you and I have advanced that if there is a higher commission associated with an insurance policy or a product, and this practice is widespread in the industry, the consumer is going to be the beneficiary because he will therefore be getting better and better products, better and better policies.

Ms. MITCHELL. I don't support that notion, of course. I guess I will try to answer that question very broadly.

If you look at the way insurance prices, insurance premiums are constructed for life insurance, they include an allowance, obviously, for the expense of acquiring the business and they also include the cost of a certain number of policies lapsing because of the high replacement rate.

That increases the total cost of the insurance to the buyer to the extent that the current marketing system is inefficient and that those costs are higher than they need be. They are driving up the costs of the life insurance product.

Mr. LAFALCE. Have you ever done any study, Ms. Mitchell—and I have no idea whether you did or not—of the promotional campaigns of insurance companies with respect to their agents?

Ms. MITCHELL. We have not done anything you could call a study. We have simply collected the advertisements from the trade publications. It is very apparent that many of them compete for agents based on the size of commission.

Mr. LAFALCE. Do they very often have promotions where there is a weekend for you and your wife to Bermuda or what-have-you, based upon the sale of certain types of policies? Is that or is that not——

Ms. MITCHELL. That is included in some of the ads, yes.

Mr. LAFALCE. We are also going to hear later that commission deregulation—which does not, by the way, mandate rebates at all——

Ms. MITCHELL. That is correct.

Mr. LAFALCE. It could permit the present system of charging commissions, plus charging a fee for service, and so forth.

In any event, we are going to hear that commission deregulation will "wreak havoc with the attempts of the insurance commissioners and the industry over the past decade to design an effective and accurate method of cost comparison of policies."

Do you consider that an accurate statement?

Ms. MITCHELL. No. I think that the marketplace has already virtually, as I mentioned before, destroyed the current cost disclosure system because of the new types of products that don't fit into the old molds.

The NAIC is working right now on a new life cost disclosure mechanism, but I think that even as the other commissioners work on it, the needs continue to change because the current period for the life insurance industry is really quite startling.

There is more change going on now than there has been perhaps for 70 years.

Mr. LAFALCE. The industry witnesses are also going to be claiming that evidence of competition is evident from the fact that the price of insurance has declined.

Aside from the fact that such an argument ignores competition amongst agents, what is your opinion of that claim?

Ms. MITCHELL. It is true that the cost of pure insurance protection has declined and the reason for this is that people are living longer. You don't have to pay as much on average any more for the absolute pure cost of insurance.

That, as you pointed out, does not go to the issue of whether agents are competitive at the level of buyers on price in a way that buyers can understand. I don't think that that contention changes that latter concern at all.

Mr. LAFALCE. Ms. Mitchell, would you explain to me, please, first of all, the concept of net pricing and then after you explain that concept, would it be your opinion that it is more probable that deregulation of agents' commissions will lead the industry toward net pricing and discounting as much as rebating?

Ms. MITCHELL. Net pricing is really the notion of the company producing a product at net cost, net of the expense of selling it, making it available to, in quotes, retailers, who will then market it up to reflect their actual costs and any profit that the marketplace will allow.

I have talked to company officials on both sides of the business, life company officials and property and casualty company officials who will tell me privately that they would like very much to do this.

They have some ideas about new marketing systems, tapping into existing marketing systems.

They are not willing, however, to come forward at this point and say it publicly for fear of bringing down the wrath of the agents who are accustomed to the current system.

Mr. MARRIOTT. Just one other question.

Do you think, notwithstanding rebating and whether it ought to be allowed or not, that life insurance commissions are too high?

Ms. MITCHELL. There is no single answer to that. That depends on the cost of selling it, of selling the product.

Mr. MARRIOTT. So you are not attacking the size of the commission?

Ms. MITCHELL. No; I am not.

Mr. MARRIOTT. I am glad to hear that. I did some quick calculating here. It looks to me like a person who buys a life insurance policy, say, with $1,000 a year premium and pays it out over 40

years, has wound up paying about 4 percent in commissions and 4 percent does not appear to be outrageous in my opinion.

Ms. MITCHELL. No. The only thing I am suggesting, sir, is if the current marketplace is very efficient and the commission properly supports all of the agents in a truly competitive marketplace, then nothing will change with either of these proposals.

May I finish? If the marketplace is not efficient, then there will be price reductions.

In some cases it is very clear that the marketplace is not efficient and that the commissions are higher than the actual cost of doing business.

As I said, conversely, it is also true in certain instances that commissions don't even cover the actual cost of doing business. That is unfair whichever way it goes.

Mr. MARRIOTT. I am not sure I can buy the idea that fees are going to help the consumer but, you discount the fact that a life insurance policy is such a complicated animal that we are better off with built-in fee structures rather than opening it up to the marketplace?

You cannot see any logic in that argument at all?

Ms. MITCHELL. I guess I cannot and perhaps a brief explanation of that would help you see why. In my former incarnation I headed the Wisconsin Department of Regulation and Licensing which housed the professional boards, the doctors, dentists, accountants, veterinarians, watchmakers, as it happens.

In that capacity, I confronted this same argument with everyone of them. They were going through the same throes of deregulation of unfixing their fees, whether they were fixed by informal agreement or by some sort of State law, and each of them made the same contention and each of them truly believed it.

So the argument to me has become less persuasive, perhaps because of the number of times and variety of circumstances in which I have been exposed to it.

Mr. MARRIOTT. You were never in the life insurance business?

Ms. MITCHELL. Yes, I was.

Mr. MARRIOTT. Doing what?

Ms. MITCHELL. Selling life insurance.

Mr. MARRIOTT. How long?

Ms. MITCHELL. Three months.

Mr. MARRIOTT. Commissions weren't high enough?

Ms. MITCHELL. I don't pretend to be an expert in the sale of life insurance, which is why I don't use that particular example.

I was in the business long enough to see some really unfair things that happened to some buyers.

I considered them to be unfair because of the commission structure.

I did see, for example, a factory worker who was in his 20's with three young children and an unskilled spouse who had a very costly whole life policy for $10,000.

He could have, at the rates at that particular point in time, have had five times as much term insurance for the same amount of money. Had he died, there is no doubt in my mind, nor do I think there would be any doubt in your mind as a professional agent, that he should have had the term.

That is one example, but I did see those things.

Mr. MARRIOTT. Thank you, Mr. Chairman.

Mr. LAFALCE. Ms. Mitchell, I really want to thank you. I think that you have been both an outstanding witness and an outstanding pioneer in what I think could be a major breakthrough for the American consumer.

As far as I am concerned, the existence of these price-fixing laws on the books of the 50 States represent an outrage to logic and equity and the free enterprise system.

We thank you for your initial great steps in trying to make this breakthrough.

Ms. MITCHELL. Thank you, Mr. Chairman.

Mr. LAFALCE. Now, I would like to call a witness who needs no introduction, Mr. Ralph Nader.

TESTIMONY OF RALPH NADER

Mr. NADER. Thank you, Mr. Chairman. Before I get into my prepared remarks, I would like to say this is a very good issue because it raises the challenge to those alleged conservatives who like to promote the concepts of free competition, it raises a challenge of power politics.

I think you will see on this issue there are people and groups who are coming from both sides of the spectrum, liberal and conservative, who support your concept of eliminating this particular cartel system and I look forward to President Reagan's appraisal of your proposal in the context of his free enterprise language which he has disseminated all over the country.

Second, I think the question of whether there should be allowed, or rather whether there should be required by State law, price fixing in this area of insurance agency is one that will be resolved one way or the other at the Federal/State level or in the courts.

Already there are clear precedents in some State courts, such as the State of Florida, applied to other occupations, and professions which indicate that these statutes will be declared unconstitutional or perhaps contrary to local or State antitrust laws.

In Florida the train of judicial decision has been quite consistent in this respect, and there is now a case in Florida which will be decided in the not-too-distant future regarding the Florida antirebate law.

I also note that the attorney general of Massachusetts, Mr. Bellotti, has just recently come out in favor of eliminating the antirebate law in that State in an advisory opinion, and since the wave of anticartelism has spread over the legal profession with the abolition by a nine to zero Supreme Court opinion a few years ago of the minimum fee schedule, abolition of the ban on advertising, the abolition on the ban of pharmacists advertising the price of their drugs and many other similar decisions, it won't be long before it approaches the insurance agent bastion.

It is nice that you have this proposal also because there is such a horde of insurance lobbyists in this town with nothing to do and they are very excited about your hearings, and I would hope that way they will let their members back home know they are protecting themselves from the Federal ogre.

I would hope these hordes of insurance lobbyists would have joined Allstate and State Farm vigorously a few months ago to establish crash protection systems such as air bags as standard equipment on all cars, and that would also have increased the number of jobs in the State of Utah because one of the producers of air bags is in the State of Utah.

We are here to discuss the antirebate problem, and I am very glad that you are proposing——

Mr. LAFALCE. Don't feel confined.

Mr. NADER. I am very glad that you have proposed it because you are from Buffalo. Buffalo has been getting a bad rap in recent years.

It would be poetic justice were the cold winds from the frigid terrain of Buffalo to blow over the country and cool off the hot war on consumers that these antirebate laws have been waging for so many years, for so many undeserved billions of dollars of commissions which benefited from an anticompetitive law.

I do want to commend you, Mr. LaFalce, and also the members of the subcommittee, for calling this hearing which recognizes that it is time that Congress examined the subject of insurance and took action to make insurance a more competitive industry.

The first absurdity you are confronting, of course, is the McCarran-Ferguson Act which was a beneficiary of World War II when the attention of Congress was directed to more important arenas, but the idea that insurance is not considered a subject for the Federal Government is one that was unsupported in the 1940's and certainly is more so today, as the interstate character of this industry becomes overwhelming.

Consumers would favor competition when competition works to reduce prices and improve service.

We have been on the record of suggesting that rate regulation by governments should not be permitted where there is a good likelihood that competition could replace the rate regulation.

That is not the case in natural gas. It is most definitely the case in trucking.

It is most definitely the case in insurance services.

But the consumers of insurance are aware that competition in insurance isn't working to benefit them today because the basic requirements for competition are not satisfied.

Only highly structured price competition occurs in the insurance marketplace, oftentimes with cartels allowed to exist, and the industry has traditionally operated with an information gap so great that few consumers know what they are buying or what it actually costs.

I refer to the General Accounting Office report in 1979 for elaboration of that point.

I want to focus on the problems of fostering competition in the sale of insurance. Providing buyers with adequate information so they can make informed decisions, as you know, is crucial for genuine competition.

But I will restrain myself from discussing those issues now in order to direct attention to proposals for improving price competition in this vital industry.

Insurance officials themselves have recognized that change is in order. They are currently promoting what they call open competition laws in a number of States. However, the industry's open competition proposals fall far short of meeting the requirements for real competition. The industry's open competition legislation would authorize insurance rates to be set without interference from government. While this sounds like a step to free the impersonal forces of the market, it won't. Insurance rates are often set not by impersonal forces, but by companies acting in concert, whether formally or informally. For example, some of the rate bureaus are Insurance Services Office, National Council on Compensation Insurance, and individual State rating boards in some States. The rates we pay for auto insurance, for instance, are often established on the basis of determinations made by an industry-owned organization.

I might add I believe the policyholders pay for this.

Experience shows that independent establishment by companies of class and territorial definition is rare. Few companies stray from the established industry-wide definitions. Almost none make rates fully independently.

The established industry rates include not only what they call the pure premium, the cost of paying losses for legitimate claims, but also the costs of servicing policies, as well as profits. The established industry rate is set, and this is crucial, to cover the inefficient as well as the efficient firms. The rate clears the market, not at the lowest price, but at the price of the more inefficient firm, and the added cost is passed along to the insurance consumer.

It is very evident that the open competition espoused by the insurance industry is not the same as free competition. The industry's open competition would continue to permit cartel-like pricing practices, although calling it competitive. It would, in addition, permit insurers to compete, not by price differences, but by selecting out; that is, refusing to take risks, instead of including them in their portfolios. Selection-out competition, including the infamous redlining practices, would continue, and the social purposes of insurance would continue to be ignored. Thus, under the industry's approach competition would result in more redlining, more discrimination by irrelevant factors such as sex and marital status, and whether one is a musician and one is a clergyman. When asked why this question was a matter to be considered, it was said that maybe clergymen are considered because they have more things on their mind.

Competition in this area could result in more delays in claim settlement and other manifestations of profiteering on the money supplied by consumers for the purpose of loss payment, not profit. It is clear that the insurance industry is not seeking to improve the competitive system significantly, but rather only to improve their already high profit levels.

Eventually we must, in this Nation, foster price competition among insurance companies that is based on individual company costs and profits. This will require that current pricesetting practices be stopped, and that pricesetting for services and profits be separated from establishing the price that is required to cover the

costs of legitimate losses. In short, the cost of bearing pure risk should be established on the basis of actual experience, by a joint Government-industy statistical board, with consumer representation and should not enter the competitive pricing arena.

This is discussed in appendix A of my statement.

[Appendix A follows:]

APPENDIX A

Competition in Price for Service in Insurance

Competition for the pure loss component of the rate leads to adverse consumer affects such as redlining, sex discrimination and slow claims settlement. Thus, the pure premium must be regulated. A government-industry Statistical Board, with consumer representation, should establish this part of the rate. This government-industry board would function to collect experience, analyze it, consider economic trends and establish the pure premium. On the other hand, the costs of servicing policies and making profits should be thrown fully into the competitive process. The insurance rates quoted by different companies should reflect differences in service and profit margins only. They should not reflect differences in selecting-out persons who need insurance.

This makes sense because if we encourage price competition over the pure risk element of cost we are likely to intensify competition by selection-out, and we possibly will reach the point where only those persons who make no claims will be insurable under ordinary terms. Permitting competition through the selection-out of risks undermines the basic purpose of insurance which is to include, rather than exclude, legitimate risks in a common fund established to compensate those who have suffered losses from causes beyond control.[1] Encouraging competition in the pure risk area encourages insurance companies to act like gambling casinos which seek to make money by taking only chances that are risk-free.[2] That's very different behavior from that of the insurer who administers a common fund established to spread risks of all persons who need to insure against loss. Our present system which permits insurers to compete with each other by refusing to permit legitimate risk-bearers from participating in the common insurance fund, makes insurance a floating crap game. And the common insurance fund becomes the stake which is up for grabs.

No wonder industry leaders have predicted that 50 percent of the car owners in the Northeast will be refused private insurance and will have to be placed in an assigned risk plan by the year 2000.

Compare this to insurance as it was originally conceived. Insurance developed as people got together to share each other's risk, so that those who suffered a loss could be made whole by those who did not. Over time, managers were hired to oversee this transaction. In the last 100 years, this socially desirable industry has been perverted into a gigantic money-making machine more for the benefit of the managers and stockholders than for the people who supply the money and produce the results. Yet, the real insurance company, as insurance began and is today, is the people. The people supply the money. The people supply the product—the claims experience. All that what we call the "insurance companies" do is to act as bookkeepers and claims settlement agents. They are entitled only to bookkeeper and settlement agent profits and authorities. They should not determine who gets coverage. The real insurance company, the people, should make that determination.

Permitting insurers to compete by refusing more and more legitimate risks freezes consumers in the marketplace, afraid to shop, and undermines the consumer's role in making competition effective. We've all heard someone say: "I guess I'll stay with my present insurer. I've been with them a long time and have had no claims. So if I have a claim, I figure they won't cancel me." Price competition stands little chance of influencing such a consumer. An underwriter's phrase also captures the same phenomenon from a different standpoint: Underwriters know that they "never get fired by say 'no" to a risk that they're uncertain about. An industry executive put it this way:

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[1] See "Full Insurance Availability," U.S. Department of Housing and Urban Development, 1974.

[2] If, say, Aetna succeeded in achieving a "perfect" portfolio in a state; a portfolio which produced no losses, yet Aetna charged $10 million for the pure loss portion of the rate, would society accept this as Aetna's profit? Or would it be the consumer's money taken for loss payment purposes and subject to being returned to the consumer?

A company cannot permit its risk portfolio to contain a disproportionate share of unprofitable business . . . hence the selection process goes on as companies attempt to match their voluntarily written risk portfolios to the rate levels that competitive forces will allow . . . what we expect the underwriter . . . to do . . . is . . . make this risk portfolio come out with a result that will fit this rate level.[3]

It's increasingly clear to everyone that our existing insurance industry isn't working well; it's not a competitive industry; and it's rapidly becoming something other than an insurance industry. From a consumer standpoint it's looking more and more like a gambling cartel. Congress should start to act to turn the industry back to being managers of the common fund, and to restore the real price competition for the services insurers perform which assure consumers the best product at the lowest price.

Mr. NADER. Once the pure loss cost is established, then competition between companies can be relied upon to establish the price or the remaining portion of the rate, the expense portion that covers the services the company performs. Ultimately this split pricing approach to ratesetting will best serve the Nation's consumers. The rationale for wholesale denial of insurance will disappear at this point.

This needed system is not about to emerge full swoop. Insurance companies are too strong vis-a-vis unorganized policyholders. However, there is an area where competition can work that should be far less controversial to establish, that will benefit consumers and be a step in the direction of the goal I have described; an area which is consistent as well with industry calls for more competition. The very first step, Mr. Chairman, is for Congress to take action to expand price competition in the industry at the retail level. Congress should pass legislation which would require the States, as a condition for continuing their stewardship over insurance industry affairs, to enact legislation to do two things:

One, prohibit companies from including any allowance for sales commission in the established insurance rates; and two, repeal existing State laws which inhibit competition among sales agents such as the laws which prohibit so-called fictitious groups; that is, groups of consumers joining together to qualify for discounted group insurance purchase rates.

Imagine how far the insurance companies have gotten under so-called State regulation when the fictitious groups concept is still prevalent, except in some States such as Michigan, due largely to pressure by the United Autoworkers.

Permitting sales commissions to be included in company established rates is like the old days in manufacturing. You will recall those good old days of monopoly pricing when manufacturers didn't just recommend their prices, they required them. The consumer could count on a gadget costing the same anywhere he or she purchased it. Now the consumer can shop and secure a large discount. Today competition is working better at the retail level, except when you go to buy insurance. A Hartford Insurance Company's automobile policy costs exactly the same regardless of where you buy it. But why should it? It just doesn't make sense for the price to be the same to the consumer when retailers have very different costs and very different concepts of how much money they want to make on a policy. Why should an independent insurance agent, selling a Hartford policy, who is more efficient and

[3] Mr. A. Burgoyne, then-President of Metropolitan Property and Casualty Insurance Co.

provides better service not be able to capture a larger share of the business by competing in price with the less efficient Hartford agent?

And why shouldn't consumers be able to band together find the insurance agent who would be free under your proposal to give them a better deal?

There isn't enough attention in this discussion with your proposal on how the elimination of these antirebate laws will encourage further pressure to get rid of the fictitious group nonsense and encourage consumers to band together in larger and larger numbers with expert staff, buying staff or agents, to turn around and give the insurance industry some informed, selective medicine?

The business groups go to insurance brokers who are expert buyers, like Marsh-McClennan, and certainly it is time for groups of consumers to be given that kind of opportunity, certainly not to be prohibited from doing this.

The commissions paid insurance agents for their services as retail salesmen are a significant part of the cost of an insurance policy. Commissions paid agents for selling insurance range broadly, depending upon their employment status, the type of insurance, and company policy. An agent employed directly by a company, often called a captive agent, may receive as little as 5 percent of the first annual premium charge for an auto policy. In contrast, an independent agent who sells a whole life insurance policy may receive more than 100 percent of the first year's premium paid by the buyer. Insurance premiums are big dollars, and insurance commissions likewise amount to big dollars. It is estimated that if competition would lower commissions by only 10 percent, there would be savings of $2 billion for American consumers every year. Consumers have a considerable financial interest in the outcome of this hearing, Mr. Chairman.

Competitive agents have a similar interest. Agents like the late Joseph Blumenthal who, trying to break in as a new agent selling life insurance in Florida, desired to sell at a discount in order to get off to a good start. He could not, and had to resort to suit in Florida courts to try to gain the right to save money for consumers. He died trying, before the Florida Supreme Court decided the case. The Dade County Consumer Advocate's Office has recently filed a suit on the same grounds. Later this morning I understand you will hear from an agent that wants to sell at a discount. I am confident that efficient agents will welcome the opportunity to compete with their more inefficient brethren in the price trenches in the good old American tradition.

By prohibiting insurance companies from setting a fixed price for retail costs, Government can very clearly improve the working of and expand the role of competition in the sale of insurance to the benefit of consumers. Similarly, by requiring that States repeal laws which restrict other forms of competition in the sale of insurance, greater scope will be permitted market prices which benefit the people. It is clear, for instance, Mr. Chairman, that the fictitious group laws have been passed by State legislatures to favor the special interest of inefficient agents, and not to promote free competition. These practices and laws are anticompetitive and should be eliminated.

Professor Scheel of the State of Connecticut, I think, will be able to elaborate on other restrictions on competition at the State level. In almost all States, even employees of a company cannot join together to buy auto insurance at a discount. Artificial barriers to competition in State laws such as this have benefited special interests, and penalized not only consumers, but efficient producers alike. A system of laws which permits greater competition rather than less works to increase both consumer demand and production.

Mr. Chairman, insurance is very big business. Most people do not realize how big a business it is.

The assets of the American insurance industry are 2½ times those of the oil industry, nine times those of the automobile industry. Insurance assets are valued at two-thirds of the combined Fortune 500 corporations.

If the day ever comes when the United States of America is put up for sale, the insurance companies will be the most able to buy it.

The Federal Trade Commission estimated, when the FTC was still permitted to study the insurance industry—without the approval of the House or Senate Commerce Committees—the Federal Trade Commission estimated that insurance premiums absorb almost 12 percent of the consumer's disposable income. That is more than energy purchases absorb. The National Insurance Consumer Organization has estimated that insurance premiums absorb nearly as much money as personal Federal income taxes.

Do you ever hear of a movement where policyholders are asking what in the world are they getting for that money? It is beginning to come close to the Federal individual tax dollar.

The Federal Government has a clear interest in the insurance industry, even though it has chosen to delegate the regulation of the industry, under the specific minimal conditions set forth in the McCarran-Ferguson Act, to the State. Consumers also very clearly have a considerable interest in this big dollar business. It is not only a matter of economics; insurance is vital to this country and to individuals. The social purposes of insurance have been ignored for too long. I strongly urge this body to begin right now to improve our insurance system by enabling competition to do its work at the retail level.

I have submitted for the record a copy of the advisory statement by Attorney General Bellotti of Massachusetts.

Thank you very much.

[Material referred to above follows:]

COMMONWEALTH OF MASSACHUSETTS, DIVISION OF INSURANCE

HEARING TO FIX AND ESTABLISH 1982 MOTOR VEHICLE INSURANCE RATES

(Advisory Filing of the Attorney General, Francis X. Bellotti, Sept. 15, 1981)

COMMISSION EXPENSES

The Attorney General accepts MARB's approach to determining the commission expense allowance.

The Attorney General wishes to note that the continued use of fixed premium to commission ratios is incompatible with a competitive market. To require companies to compete, while restricting the range of agent's commissions, is analogous to allowing competition at the wholesale but not the retail level. (Such agreements in

the sale of consumer goods were banned in 1975 by the Consumer Goods Pricing Act which repealed the so called "fair-trade" laws.) Forbidding competition in commissions will injure agents by eliminating the flexibility they will need to respond to the expected influx of direct writers after deregulation.

LOBBYING OFFSET

The Attorney General proposes a one-tenth of one percent lobbying offset to company expenses. The Attorney General also requests that the Commissioner order the necessary data collection to determine the size of lobbying in the expense data so that any future fix and establish proceeding can have the benefit of a more accurate estimate of this offset.

Lobbying by insurers takes many forms, and appears in several parts of the expense data.

Mr. LAFALCE. Thank you, Mr. Nader. As a matter of public interest, it is my intention to proceed until approximately 1 p.m. and then take a break for lunch until 2 p.m., resuming the hearings in the afternoon at 2.

Mr. Nader, a few questions.

From your knowledge of the insurance industry, are you aware of anything that should place the agents of this particular industry beyond the principles of free enterprise and, in particular, simple price competition?

Mr. NADER. No; nothing at all. Not only do we have analogies where these barriers have been broken down such as in the stockbrokers' service and the legal service or where it hasn't existed in other professions, but it is quite clear that the creativity on both sides of the marketplace by the efficient agent, creative agent as well as by the efficient or creative consumer or consumers will just be significantly enhanced by eliminating these antirebate laws.

Mr. LAFALCE. You and I share a very similar concern about the importance of disclosure when it comes to insurance in general. Would it be your opinion that deregulation of agents' commissions might lend itself to greater disclosure initiatives by the agents, and how do you view the industry claim that deregulation would upset recent State commission and industry efforts to design an effective and accurate method of cost comparison?

Mr. NADER. Well, I think the two aren't incompatible.

In other words, there could be a system of comparisons as a function of the Government's role in preventing deceptive advertising.

At the same time it is important to note that there are always risks to competition. For example, when the ban on lawyer advertising was cast aside, it was anticipated that there might be some deceptive ads by lawyers and there may well be, but that can be taken care of not only by peer group or professional discipline, by the Bar Association, but also by the traditional antideceptive advertising rules at the State and Federal level.

I think that one thing that even unorganized agent disclosure will do is begin to educate more policyholders in the area of differences between policy and between the bundle of services that insurance agents can provide.

Just like when you start telling people about the difference between car crash performances, the long range impact of that is that consumers begin walking into dealerships and asking questions dealing with safety and dealing with different performance levels of different model cars.

I think the future will bring a much more organized discipline by consumers and by consumer organizations in this field, but you can't even get started if you have these restrictions in State laws.

Mr. LAFALCE. Let's discuss the subject of State laws.

One industry representative is going to seek this afternoon to rebut the need for Federal legislation by claiming that, the States have taken a responsible legislative regulatory approach incorporating a studied understanding of the needs of their constituents, balanced with a State competitive marketplace with the ability to provide the insurance product at fair prices.

Based upon your study and experience, would you care to share your views on the validity of that claim?

Mr. NADER. First of all, I would challenge the insurance industry and the insurance agents to let an impartial professional polling organization poll the American people on this issue.

Basically ask the American people do you want insurance agents to compete over their commissions and be free to discount commissions when they sell you insurance policies?

Just why not poll their customers instead of presuming?

Second, this is the United States of America; emphasize "United." When you have clearly an interstate industry like insurance, the National Government of the United States of America has just as much business dealing with this issue as the State governments.

Whatever was passed under McCarran-Ferguson can be unpassed by the same legislature a few years later.

Mr. LAFALCE. Thank you very much, Mr. Nader.

Dan?

Mr. MARRIOTT. Thank you, Mr. Chairman.

Let me just ask a couple of questions. I guess we ought to have a hearing on when is competition is not competition. The thing about which I am somewhat puzzled in your statement is this business of price fixing.

Simply because an insurance company builds a commission structure into a product which is a long-term product, premiums payable for life or 30 years or 40 years or some such thing, why is a built-in commission antifree enterprise? Why is it price fixing?

I will bet 90 percent of the things we buy, somebody makes a commission on it in some way, but we don't discount those every time I walk into a grocery store, or a department store.

Why is a built-in commission schedule antifree enterprise and price fixing?

Mr. NADER. The simple answer is because of the independent American agency system.

These agents make a big deal out of saying that they are independent business people. They are a separate entity, and I don't think we would ever allow a drug company to build in the pharmacy's fee as the price of the drug or to build in the doctor's fee of prescribing in the price of the drug.

These are separate business entities and they should be arm's length with one another and not be dictated to by the seller which, of course, is the rationale given against resale price maintenance in other areas of our economy.

Second, it is extremely coercive of consumers who would like to bargain with their sellers.

I think we ought to encourage bargaining as much as possible between consumers and sellers and not have industry-passed laws which prevent such bargaining, unless there is a really overriding argument that can be made which outweighs the competitive one. I haven't seen it in this area.

Mr. MARRIOTT. I have taken on the insurance industry in a number of areas. For example, almost anyone today can hang a shingle on their door and call themselves an estate planner or a consultant of some type, when what they are really doing is selling insurance.

I have contended that about 1 in every 10 agents who have ever been on the street are really competent, fully knowledgeable agents, although I admit that may be too low a figure now a days.

When you come back to the concept of the previous witness that perhaps we ought to have a flat price of insurance and allow everybody to mark it up as they see fit, is that the answer to this, Mr. Nader?

How do we—if we simply do what you are suggesting, prevent that 90-percent group or 10-percent group, or whatever figure in-between they might be, of incompetent agents to rip off the public even more with outrageous commissions?

Mr. NADER. Well, first of all, that is an interesting figure. I will be very happy to cite you in the future.

I find myself even—I find it difficult for myself even to agree with that—1 out of 10?

But, anyway, the licensing of insurance agents could be made a little more rigorous in terms of trying to make sure people who do sell insurance know what they are doing. That is important. So you can approach it that way.

Second, there will always be fly-by-nights in any industry. We should deal with those under the economic crimes or economic deception laws; not deal with those presumably by restricting competition, because I don't think restricting competition takes out the incompetents.

By your own percentage, under the present system of antirebate laws, 1 out of 10 are competent. I am sure the 1 out of 10 do more than 10 percent of the business, but still we should not mix apples and oranges.

Where competition is able to occur, it should be permitted to occur. If there are rough edges, like safety hazards or deceptive advertising, they should be taken care of under consumer protection laws.

Mr. MARRIOTT. But you think whatever the number might be, 1 out of 10, 5 out of 10, 7 out of 10, who knows what the figure is, the consumers would fare better by having a rebating law in existence?

When all of the smoke clears, is the consumer himself is going to benefit from this?

Mr. NADER. Yes. It isn't a rebating law. It is just letting them rebate.

It doesn't require it, of course. Yes, for two reasons.

One is, there will be a significant number immediately of consumers who just want to buy insurance and know what they want and they don't want to pay more than they have to.

There will be those consumers who have a friendly insurance agent that charges them after the laws are repealed the same as before because they liked the man, or the woman.

They go to the same clubs, they are neighbors, they trust the agent.

That is happening now in the brokerage area. There are a lot of people who still pay twice as much or more for commissions just because they are accustomed to their old broker before the fixed rate commission was abolished.

Second, most important, you have to ask yourself not only what is the immediate response after these laws are repealed, but what is it going to be 5, 10, 20 years from now when consumers learn that if they band together in a neighborhood and buy a group homeowners' policy, which will require the elimination of some of those State laws, fictitious group laws, then it will be even greater benefit.

What you allow here is group bargaining by insurance policyholders once you get rid of these anticompetitive restrictions.

That I can see not only becoming an economic efficiency plus, but I can see that eventually consumer groups will bargain with insurance companies not only on the coverage and the price, but on what these insurance companies are doing on safety.

For example, in a homeowners' policy, what are they doing trying to fight street crime? What are they doing on fire prevention?

All of which, if they worked on these areas, would help reduce their claims. So it is right on with the old Lloyds of London insurance practice of requiring ships going to India to have lifeboats. That is what the real significance of this is beyond mere dollar saving.

It is making insurance flower in its complete social purpose, which is not just to cover tragedy after it occurs, but to try and help prevent it.

Mr. MARRIOTT. I would take it that you would rather see a wholesale life insurance policy established rather than dealing with making rebates legal?

Wouldn't that be a better way to safeguard the industry?

Mr. NADER. Net pricing, you mean?

Mr. MARRIOTT. Net pricing.

Mr. NADER. Yes. The best way is to do net pricing and let them compete on anything that they add to the net pricing.

Mr. MARRIOTT. And let them disclose what that commission is, or do you think disclosure is necessary?

Charging a fee in addition to the net product would be a form of disclosure, would it not?

Mr. NADER. Well, I think if there is competition, disclosure of what the fee is isn't that important, and maybe later on the consumers could privately negotiate these kinds of disclosures, but I don't think that is quite as essential.

Also, once you have competition, someone will come along and disclose it as a business. It will be a consumer's service.

Mr. LAFALCE. I have to point out my bill would permit precisely what Congressman Marriott is talking about.

Mr. NADER. Yes.

Mr. MARRIOTT. Thank you, Mr. Chairman.

Mr. LAFALCE. We are going to have to bring your testimony to a close, Mr. Nader. I thank you very much.

Mr. NADER. Thank you, Mr. Chairman.

Mr. LAFALCE. Our next witness will be Dr. Meyer Louis Burstein, an economist from York University, Toronto, Canada.

TESTIMONY OF MEYER LOUIS BURSTEIN, ECONOMIST, YORK UNIVERSITY, TORONTO, CANADA

Mr. BURSTEIN. Thank you, Mr. Chairman.

Mr. MARRIOTT. While we are waiting, I thought it would be a good idea to put the congressional salary schedule on that same type of free enterprise system we just talked about.

Perhaps if we got paid what we were worth rather than on a fixed salary, it would be great.

Mr. LAFALCE. I think that might be a great idea, Dan. Why don't you introduce the bill?

Dr. Burstein, before you begin, it is my understanding that you are associated in some way with the Heritage Foundation, and that the Heritage Foundation was kind enough to arrange for your appearance here before this subcommittee although because of their tax status it is imperative to point out that the views which you are expressing today are yours and yours alone and not necessarily the views of the Heritage Foundation; is that correct?

Mr. BURSTEIN. I am glad to state that. I was—my expenses were being paid by the Heritage Foundation. I am associated with them only in the sense that I am on a list which they keep of people whose opinions they think they might want to have from time to time.

I have no continuing relationship with the foundation. Also, I am a U.S. citizen active in American affairs. I happen currently to be employed in Canada.

Mr. LAFALCE. I think the point I wanted to make at least has been made.

Please proceed.

Mr. BURSTEIN. I am glad to do so.

I would like to supply a very brief gloss to what I have to say.

I came to this hearing with some experience in insurance, but primarily as a specialist in industry economics, the theory of price, and that sort of thing.

Congressman Marriott has me cautious about these things. I am not a specialist in the insurance industry. Accordingly, I felt my best contribution would be to bring this into a broad focus of industrial pricing.

In that connection I was very strongly struck by the analogies which exist in this problem to those in the stockbrokerage and computing industries, the bundling question.

The purchaser of an insurance policy essentially is buying, as I think Mr. Nader rather stressed, two products. He is buying something you call a raw insurance product which, I draw the analogy of that to the hardware in a computing context; together with that,

he is buying the agent's services, which are well known to all of the people here.

In a bundled pricing scheme such as that once imposed by IBM and such as that which was once overwhelming in the stockbrokerage industry, you pay a single price for the entire package. That is essentially the way in which insurance now is marketed.

To the extent that you do observe rebates from agents, talking legally now, I would note these have two effects. It concerns the extent to which the agent is accordingly charging less for his services than otherwise he would and, second, however, due to the fact that the basic insurance product is itself sold according to schedules, you will often find situations in which any rebate now or under your proposed act, then legally would also involve a process in which the insurance itself, the basic insurance, was being discounted.

As things stand under the system that exists, one must carefully note that a rebate offered by an agent may pertain to his own services and it may be indirectly a way of reducing the price of the basic insurance product, what I have called the hardware, the pure insurance component.

Finally, by way of gloss, Mr. Chairman, your bill is, of course, directed at the element of inflexibility which now exists in the prohibition of rebates.

I would have to say that I would perceive that myself, ideally, as a first step toward a complete deregulation of the industry.

As a matter of fact, as I studied this problem, I found I could not completely separate out your bill from the question of the general scheme by which we price services once I recognized that a rebate given by an agent may be an indirect way of discounting the basic insurance product itself.

I will now proceed through my prepared statement.

In modern economics, products are perceived as bundles of properties. Special stress is put on information and knowledge and economists now study the costs of acquiring and diffusing knowledge in the same way that they long studied the cost of extracting, processing, and distributing coal.

Turning to the analogies, the stockbrokers' services or computers, if I bought a personal computer, the hardware would be a plaything for me until I was taught how to use the machine.

Programs would have to be selected and perhaps devised for me. I would have to be taught how to manipulate the materials. My progress would have to be monitored and my experience studied so the knowledge generated could be used to lead to improved programs and so forth.

I recently observed some computer-guided processes of the Monsanto Corp. Companies like Monsanto have vast software capability. Monsanto would only buy unbundled computer products. It would buy hardware and not pay computer companies for instructional manuals.

Not long ago, stockbrokers' services were sold bundled. Customers bought packages including research and portfolio balance guidance.[1]

By the midsixties it became clear to unbiased students of the securities industry that procedures services would not be supplied only as bundles in a free market.

More sophisticated clients with high research capability or sufficient intelligence to identify rubbish as rubbish would in a free, unbundled market, buy only hardware; that is execution of trades.

Less sophisticated clients or clients lacking the desire or opportunity to study the market often, but not always, would buy bundles. After the securities markets were freed up, following a fierce struggle, the results very well conformed to forecasts of the reformers. Relatively small houses specializing in the supply of cheap, efficient execution thrived. Houses specialized in the sale of research would have done better if rapid propagation—misspelled in the text—of efficient market hypotheses, well supported by empirical evidence, had not cast deep doubt about the value of such research.

Many clients, as Mr. Nader pointed out earlier today, have continued voluntarily to buy bundled products paying higher commission rates.

I conclude these general remarks with two observations that I think are mandated by the best modern theory.

The second leads to insurance.

First, when bundling is imposed upon a market by force,[2] whether it be the force of a monopolist, a cartel or a set of laws under which Government acts as a cartel's enforcer, the result must be economic inefficiency and impingement on the basic right of citizens to trade freely.

Second, the free operation of markets leads to incessant redefinition and reassessment of the product and the service, together with the modalities through which the suppliers are paid.

In particular, it is likely that, when a product is new, commissions-on-sales will predominate in agent compensation, thus encouraging agents to promote and introduce the product; as the market matures, conventional salary payment becomes more important as more work concerns maintenance of existing stocks—for example stocks of policies. The presently prevailing predominant mode of insurance agent compensation is a function of McCarran-Ferguson type laws and not of a free market.

Moving from theory to empirical evidence, it is the overwhelming consensus of economists that unbundling in such areas as computers, securities and via deregulation of airlines and truckers has significantly increased economic welfare by permitting supply of a wider variety of services and combinations of services at lower prices.

The LaFalce Act is fully supported by correct economic analysis and indeed may be necessary for its implementation in the insur-

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[1] There is a good analogy to block-booking practices of motion picture producers/distributors. These have been conclusively explained by Prof. Lester G. Telser (Journal of Business, 1979) and earlier were illuminated by Prof. George J. Stigler.

[2] Substantial bundling will come about voluntarily in free markets. It will result from cost-efficiency pressures. Attempts to market car bodies and engines separately would fail. But they should not be prohibited by law.

ance industry. This conclusion flows from an analytical breakdown of the products sold by the insurance industry.

Here I make some remarks which in fact reflect an area in which I have some expertise, the theory of resale price maintenance.

A fellow student at one time, Lester G. Telser, now professor at the University of Chicago, brilliantly explained, I think, the origin of the price maintenance concept, in an article called "Why Should Manufacturers Want Fair Trade?"

The answer is that in the early stages of a product it is often extremely important that the potential seller of the product both through time consuming and expensive procedures to explain the product to the customer and, of course, he would only do this if you are insured a high margin.

So in the early days of stereos and products of this sort, the stereo manufacturers had an interest in fair trade, in maintained prices.

I suspect, although I have not had the opportunity to do research to support or falsify this suspicion, that the origins of the commission system in insurance are similarly explained.

I would go on to believe that in the present state of the insurance industry that if you undid history and just started de novo and asked yourself how would you set up a logically organized insurance industry, that the commission system would have much less importance in compensation than, in fact, it does.

I move on by applying my analysis to Congressman LaFalce's proposed act. The act, I think, is fully supported by correct reasoning.

The purchaser of insurance buys the benefits defined by his policy. This I call the hardware, duties, powers, rights, liabilities, of the parties.

Such buyers may or may not want related software services. They may or may not want to buy packages of agents' services that might be bundled into these policies.

More realistically, buyers would at given prices buy different sized packages of agents' services. In a free market agents' fees would vary widely depending upon the characteristics, surely including sizes of the packages they sold.

Buyer B might be like Monsanto in my computer industry example. The highly sophisticated B would not be prepared to pay anything for an agent's services. Buyer C may need a lot of advice, both when he buys insurance and over the policy's life.

C may need a package including monitoring of his situation, accounting help, tax advice, coverage revision, and so on. C may want to buy a bundled product or a software package as well as the hardware comprising the policy.

I go on to explain that if we started over I would suspect the role of agents would be compensated on a rather different basis than they now are.

If we could start anew, constructing a rationalized insurance industry independent of its long and fascinating history—a social engineering process that might be abhorrent for reasons explained by Aldous Huxley and George Orwell—insurance per se [hardware] would be sold net of commission. [See for example, Paul W. Mac-

Avoy (ed), Federal-State Regulation of the Pricing and Marketing of Insurance (Washington, D.C.: American Enterprise Institute for Public Policy Research)]. Commissions would be negotiated by insurers and their agents. Payments for agents' services to policy holders would be negotiated by these parties, together with insurers.[3] Buyers of policies obviously have no proper interest in the ways in which agents and insurance companies negotiate the former's compensation.

In an ideally reconstituted insurance industry, having all the hardware, all the software, would be bargaining out in the open, unhampered markets and a growing mountain of evidence tells us that the upshot would benefit the consumer in society; competition assures variety and cheapness and maximizes choice.

The LaFalce proposal is addressed to the insurance industry we have, an industry shaped by its history.

Under this proposal the proportion of direct insurance cost incurred by buyers that would be classified as commission would vary between policies in an economically constructive way, I would say.

Payments would better reflect what agents do; agents, acting on behalf of insurers, would have more leeway in pricing flexibility, thus better accommodating risk differentials not reflected in heavy constrained printed schedules.

The point I just made concerns the intersection that I described earlier between the proposed act and the general pricing of insurance. The proposed act would seem on casual inspection just to concern the agent's compensation; however, let us keep in mind that rebating by agents often is not so much a discount of their own services the underlying insurance program.

This issue, by the way, intersects Mr. Nader's testimony in a number of ways.

I might say I only just heard that testimony.

Notice his distinction between the pure risk element of an insurance policy and other services.

I tried to anticipate objections to this act. There might be fears of the effects of the proposal and the more radical net pricing that I support.

One concerns effects on agent compensation. It is clear from other testimony that I have read only today again that there is great concern about the effects on agent compensation.

The other concerns effects on less well informed buyers of insurance. I feel supported by the testimony I have read today that there is indeed such concern.

Taking up agent compensation, it is indeed possible that free market pricing of agents' services, together with the fact that the way things are now, agents can offer concessions substantially only at their own expense, could cause commission revenues to be too low for their supply of the industry to be viably high and their turnover viably low.

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[3] Better-qualified, more industrious or more-able agents would tend to command what economists call "rents of ability." The superiority of their services would command a premium in the market.

I want to emphasize that I cannot see how a prior reasoning could exclude that possibility. I have not been asked to study this problem from a statistical point of view.

But it is absurd to suggest that because revenues obtained through commissions could thus be inadequate that there would be an exodus of agents from the industry. No.

What would happen is that agent compensation would be put on a more rational footing. You would have salaries, retainers, and other fees that would be put on a sounder foundation than that provided merely by values of new policy writing or the cumulant of the values that an agent has written over his career.

The second concern is the protection of unsophisticated buyers. Before turning to that, I want to emphasize that I do not consider myself in a position to say here that agents are on the whole under or overcompensated or that insurance is too high or too low.

I am approaching this as an economist. I am supposed to have mastery of economic reasoning. General economic reasoning says that the situation ex the LaFalce Act leads to inefficiency; that with this act you would have a more efficient market and that with a further reform you would have a still more efficient market.

The cases in the computer industry, the securities industry and the aftermaths of deregulation in transportation show that promotion of open marketing pricing of separated services leads to more, not less, service to the unsophisticated buyer. All the old configurations remain available; new ones are added. Indeed, the present setup unduly restricts the field of choice of all buyers.

For one thing, reliance on fixed fees for bundled packages of services makes it impossible for individual buyers to seek out the specific service they need.

Yes, they could seek out those services, but they must first pay a bundled fee and they must buy a whole package in order to obtain any one component. That is the point. Clearly the education of the consumer of insurance services best would be promoted by a pricing scheme that makes it possible for the consumer to buy raw insurance and to purchase counseling services separately. Think of the consequences of the IRS imposing a counseling fee on taxpayers so that they had to pay for tax advice from the IRS, whether they wanted it or not. What if that practice were defended by the IRS on the ground that taxpayers thus were being protected from exploitation by unethical C.P.A.'s and other tax consultants. This patently absurd line of argument is on all fours with that employed by defenders of the McCarran-Ferguson impact on insurance sales. In the end, all buyers, sophisticated or not, best are protected by intensified sellers competition which will, among other things, eliminate the conflict of interest so obvious in a situation in which sellers are made by law preferred counselors to the sometimes naive buyers of their products.

Mr. LAFALCE. Thank you very much, Professor.

Because of the time constraints, I am only going to ask you one question.

Basically I think the logic of the bill I have introduced is unassailable.

The only thing is, the insurance representatives say yes, but in every general principle, there must be a pragmatic exception; and

our industry is that exception because there are so many unique aspects to the activities and professional conduct of insurance agents that we can not permit them to compete openly with one another on the basis of commissioned rates.

Our industry is different from all the other industries. I ask you to comment on that.

Mr. BURSTEIN. Well, I thought that Commissioner Mitchell's response to a similar question, based on her earlier experience in regulation, was very striking.

At a greater distance, I have seen—although not felt—all of this. I must say that I do not myself find insurance exceptional among products in this way. I would think that it would fall short certainly of medical service in that way.

I would add to that two points.

The first is that insurance is exceptionally able to be quantified. Even if I am quite naive about insurance, it is possible for me to be faced finally with sets of numbers supplied by alternative agents.

What about lawyers? If I am being sued, for example, for the first time I now must have a lawyer. It would be extremely difficult for me to find an objective basis to set up my choice of a lawyer.

Mr. LAFALCE. Do you think that one objective basis might be that you look at advertisements for individuals who offer discounts in the legal profession and that you would be sure not to go to him?

Mr. BURSTEIN. No.

Mr. LAFALCE. I would.

Mr. BURSTEIN. If I were well financed, I would select among lawyers who charge the most, and this brings out a point: The well-heeled person probably would restrict his choice among insurance agents who charge the highest commissions in a free market, just as the well-heeled visitor to this city who is on a generous expense account [not from Heritage] would probably consider only a handful of the best restaurants before he makes his choice.

The disadvantaged person, the person with a very low income who is now being sued and who is very frightened, probably would go to one of these law firms and he would be right, because he would discover that the more famous law firms would find his case unpalatable and would not, in fact, be particularly qualified to handle that sort of thing.

The final point along this line that strikes me is one Mr. Nader made. He made it very sharply. I make it somewhat less sharply in my prepared statement. That is, we have observed in Wall Street——

Mr. LAFALCE. Very sharply what? In agreement or disagreement?

Mr. BURSTEIN. He made emphatically the fact that in Wall Street now we do continue to see people buying bundled packages just as if there had been no change at all.

I think it should be emphasized that to the extent people feel insecure in the market, that to that extent there will continue to be viably offered the kind of insurance arrangements that you now see.

We must keep this in mind, that this option, that what is now the standard, the universal, the legally mandated form, should not be expected to disappear. It will remain a possibility, I would say, under your bill.

Mr. LAFALCE. Dan?

Mr. MARRIOTT. Thank you, Doctor. I enjoyed your comments.

You know, I have been a believer for some time that insurance is a different kind of animal. It is sold, it isn't bought. People don't jump for joy when they buy it. They buy it out of necessity.

Many of the sales are more of an emotional type of thing than a logical one.

So when you put back in the fact that you have a new dimension now, with a rebate or a commission to deal with, and we can bargain with our seller or buyer over this particular commission, I take the position that it is going to hurt the industry and, in the long run, hurt the consumer.

The insurance industry is already riddled with gimmicks. There are, in fact, con artists out there. I think any sixth grader could pass the insurance exam and hang an estate planning shingle on his door.

You now have an arbitrary commission figure. If we can now deal that away, I personally think the consumer is going to get the wrong end of the stick; and, we are going to camouflage the provisions of the policy and we are going to camouflage prudent consulting with the commission.

I think in the long run the consumer will wind up the loser. I believe you have adequately separated the two ingredients. You have the raw insurance product and you have the agent's services, which bear a commission built in.

I think there is a difference between playing with a rebate on the one hand and doing what I suggested on the other, that is having a net policy and allowing for a negotiated fee to provide insurance services.

I think there is a big difference in what the net effect on the consumer will be.

Do you agree with that? Or do you think that this rebating idea is really all that great?

Are you really telling us that maybe we ought to talk about the former option?

Mr. BURSTEIN. Well, to start with, my main contribution here was to make clear the distinction between the two components of the bundle. The way you put the question satisfies me that I have accomplished the main thing that I could have hoped to have accomplished because I did not come here as a specialist in the insurance industry.

I would say that the extent to which the law permits these two aspects to become isolated would lead to more not less respect for the counseling and general service aspect of the agent's function.

I think that as things stand today the consumer typically does not distinguish the commission from the basic insurance; and he is confronted with a single price.

While he perhaps is aware that the only freedom that the agent has is over his commission, that he might rebate the commission,

the consumer under the present system, however, sees this really as a way of discounting the total cost of the package to him.

Mr. MARRIOTT. If that were the case, I think I might put some credence in what you are saying. But, I don't think the average consumer is analyzing all these provisions of an insurance policy, and then saying that the commission is just an extra kicker if he gets half of it back.

Mr. BURSTEIN. I am making the consumer as simple as he can be. He just asks how many dollars does this thing cost. Here is a guy offering it for less. I agree with you, and accordingly I think the present system masks, hides the contribution that the agent is making because it hides the cost of that particular contribution taken by itself.

Mr. MARRIOTT. In that case, everyone gets paid the same whether he is a good agent or an incompetent one, correct?

Mr. BURSTEIN. Since everyone gets paid the same, it is taken as part of the price.

I want to emphasize that I am here more as a supplier of logic than as someone who has done a careful study of the market. But my commonsense or intuition tells me in the majority of cases when the agent is making that rebate, what he is doing is effectively discounting the raw insurance in order to get the business and that much of this flows from the fact that the underlying product price is published in the way that Wall Street commissions used to be published.

That is the price of the basic insurance, and that it is not going to be possible to stop this discussion here.

I imagine that is why the insurance industry is so interested in these hearings. The train is going to go down the rails farther than the LaFalce bill. It is going to go down to the background issue as to how all of the components of the product are priced, and I think that in the end that inevitably both the politics and the economics of this situation are going to lead to a debate as to whether or not insurance in all dimensions should not be priced in an open market.

Mr. MARRIOTT. Thank you.

Mr. LAFALCE. Dr. Burstein, thank you very much.

If my small little bill would have that effect, I would be ecstatic. It might lead to what you are suggesting, widespread deregulation of the insurance industry, which some have called for, as you well know.

Thank you for a valuable contribution to the dialog.

I would now like to call to the witness stand two witnesses at the same time. I am also going to amend my comments. I said we would go to 1 o'clock and then resume at 2. We will go until completion of the testimony and questions of these two witnesses and then we will break and then come back at an appropriate time to be fixed subsequent to their testimony.

PANEL CONSISTING OF JOHN D. REGAN AND GORDON BOWERS

Mr. LAFALCE. Mr. John D. Regan, president of the Regan Co., San Francisco, and Mr. Gordon Bowers, of the Discount Insurance Service, Inc., Richmond, Va. We will hear the testimony from both of you and then we will question you.

Mr. Regan.

TESTIMONY OF JOHN D. REGAN, C.L.U., PRESIDENT, REGAN CO., SAN FRANCISCO, CALIF.

Mr. REGAN. Thank you, Mr. Chairman, members of the committee, I am John D. Regan, C.L.U.

I am president of six affiliated companies in San Francisco, employing over 50 people and operating in all life, health, and employee benefit areas. I am a life, health, and casualty insurance, variable annuity, NASD and real estate licensee. I have designed products for insurance companies and written extensively on insurance and insurance related matters, including a 600-page book in 1980 and a new consumer buying guide to insurance, which is soon to be published.

I am a member of the National Association of Life Underwriters, Million Dollar Round Table, MDRT's Top of the Table, Seven Million Dollar Forum, American Society of C.L.U.'s, and the Association for Advance Life Underwriting.

I am here to testify in support of H.R. 4497.

Before I get to my reasons for this testimony, I would like to step off to the side for a moment with some comments insofar as what I feel is maybe happening here today at hearings and what might be happening as a result of these hearings.

I think what we are really talking about here is change, gut wrenching, cataclysmic change which is happening in the insurance industry in general.

This is just one more manifestation of that change, another threat to the status quo.

As I travel around the United States speaking to industry groups, people are continually talking to me about that change and how they are going to deal with that change. To a large degree the talk centers around the new products that are becoming available today to replace yesterday's products.

These new products are substantially more consumer oriented, substantially more competitive by and large, and these new products have generally speaking lower commission rates.

So I think we need to separate the fact and the logic from the current feelings permeating the insurance industry. The feelings of the person going out there on the firing line selling insurance who, because of the manufacturers, that is the insurance companies, dragging their heels to respond to consumerism, when all other industries started maybe in the 1960's, now all of a sudden the insurance industry, the manufacturers that is, is starting to respond to consumerism in the 1980's; and because these companies have waited so long, the change which is now going to take place in this insurance distribution system is going to be cataclysmic.

The belief systems of the people selling insurance who have been in the business 5, 10, 20, 30 years, are being thrown out the window on a wholesale basis because we are not looking at gradual change which is what ordinarily happens in an industry as that industry responds to changes in the environment in which it operates, because the insurance industry has held back so successfully for so long, now the change that is coming is indeed a very, very dramatic change.

So as background I think some consideration has to be given to the sensitivity of the issues that we are dealing with.

Now to some of my reasons for testifying in support of H.R. 4497:

One, it allows fee for service and other alternate distribution arrangements between a willing buyer and a willing seller.

Two, negotiation of commissions is not new to the insurance industry.

In reading today some of the comments that will be made by and on behalf of the associations purporting to represent the industry, it seems that it is being suggested by these people that negotiated commissions is something new to the insurance industry.

I find that hard to square with the facts. It is an established and recognized practice in group insurance and commercial lines and casualty insurance—it is only possibly new to the individual life and health insurance products.

But even on individual life and health products, companies are allowing and encouraging agents to negotiate commissions indirectly today.

Many companies have two term or two whole life or two different paid-up at 65 products in their rate books where the only significant difference is in the commissions and that commission difference produces almost a precisely corresponding difference to the consumer in first year cash values or price and commission banding at certain volumes on term insurance.

Insurance companies now use their commission fixing ability to include agents to sell policies more profitable to the insurers, which may be to the detriment of the consumer.

Why not legitimize the practice, leaving it up to the agent with more flexibility to build the product to the buyer's specifications on the firing line.

Three, another advantage of no fixed commission structure would be more meaningful and understandable cost comparisons between company A and company B's products.

Again, in reading the testimony that will be coming from representatives of the industry, it seems to be a uniform theme throughout that testimony that negotiated commissions would wreak havoc with some of the efforts that have been made for cost comparison between different insuror's products.

I see that as being quite far from the truth. Cost comparisons of different policies could either be done net of commissions or with a standard suggested commission.

The elimination of more or more variable between different insurer's policies would make it that much easier for the consumer and the insurance agent, I might add, to compare other expenses, efficiencies, inefficiencies, markups, general overhead, yield skims, and so forth, from one insurer to the next.

Four, as has been previously stated, negotiated commissions didn't ruin the securities industry as the prophets of doom predicted.

Five, negotiated commissions may cause some marginal agents to fail, but it is doubtful, and why should Government have to provide price supports for mediocrity, if they do fail?

Six, negotiated commissions may cause some disintermediation of the agency system, but it is doubtful, and if this did happen an-

other marketing system will step into the void created, which could well be a greater boon to the consumer than this bill, to have insurance distributed through a system more independent of the manufacturers of that product.

Seven, while this bill in and of itself is not a panacea and while it is true that with the passage of this bill commissions would be the only portion of the premium subject to negotiation—and the entire premium should be subject to negotiation, H.R. 4497 would bring insurance more into line with other goods and services which cannot be fair traded, it does not appear that it would increase costs to the consumer and it would definitely lower costs for some.

Eight, it would provide flexibility and unfettered bargaining between buyer and seller inherent in a free market economy.

Nine, it would officially sanction what is being done now surreptitiously by the companies themselves and is, therefore, a step in the right direction.

Mr. LAFALCE. Thank you very much, Mr. Regan, for your testimony.

Before we question you, we will hear from Mr. Gordon Bowers of the Discount Insurance Service, Inc., Richmond, Va.

TESTIMONY OF GORDON M. BOWERS, C.L.U., DISCOUNT INSURANCE SERVICE, INC., RICHMOND, VA.

Mr. BOWERS. Mr. Chairman and members of the subcommittee; I am very pleased to be here today to speak about something which affects virtually every person in this country either directly or indirectly, and that is the distribution system through which insurance protection is delivered to consumers. While I am by no means an expert on all aspects of insurance, I am qualified to speak about the marketing of individual life insurance policies. I have been in the life insurance business for 12 years, and I have spent the past 2 years working on the development of a project which has just begun to sell what are essentially wholesale life insurance policies. To my knowledge this is the first time that this has ever been done in the century and a half history of the insurance industry.

Since the beginning of the life insurance business, coverage has been marketed in primarily one way; agents have been paid commissions to sell policies. As anyone with a knowledge of marketing can confirm, distribution of any product through commissioned salesmen is usually the most expensive method possible.

I think it is fair to say though that almost no insurance would have been placed in force in past decades had it not been for the efforts of commissioned salesmen. The society and the economy in general have benefited. However, many things have changed and there is very little resemblance between the society and the economy of today and that which existed 50 years ago. While it is certain that many people still need an agent to sell them on the idea of owning life insurance, it is equally as certain that there is a very large and rapidly growing segment of our population that recognizes life insurance as the economic necessity it is. These people need little or no encouragement to buy the protection they need. Nevertheless, they must buy that protection through the same costly distribution system that was designed to sell insurance

to people who would not have bought it otherwise. There is absolutely no conscionable reason for this to continue any longer.

The insurance industry and the body of law that regulates it have developed together and both have been very slow to change. Laws that prevent an insurance agent from rebating a portion of his commission came into being for good reasons. However, many of these reasons are no longer valid and the need for change is now dramatic. There are many agents who would gladly discount their commissions in order to encourage greater sales. I know this is true because I have talked to agents all over the country who are frustrated because they cannot openly compete in this way. There is no doubt in my mind that repealing antirebate laws would stimulate competition. The net result would be an overall reduction in the cost that consumers pay for the distribution of insurance products.

As I have previously mentioned, I have developed a system through which wholesale life insurance policies are now being marketed. The name of our company is Discount Insurance Service and our present office is in Richmond, Va. Our operation differs from conventional insurance agencies in that we get no large first year selling commission from the insurance company that underwrites our policies. A normal general agency total commission is typically equivalent to from 90 to 120 percent of premium in the first year, and 5 to 10 percent thereafter. By contrast, we receive only 5 percent each year. Further, we received no other forms of compensation such as expense allowances, bonuses, awards, convention credits, or anything else. We receive nothing from the insurance company except the 5 percent servicing commission.

Our compensation is in the form of a fee that is paid directly by the customer. The fee, however, is not paid to Discount Insurance Service. Most States have laws or insurance regulations that would prohibit an agent from charging a fee for the procurement of insurance. Therefore, it was necessary to have a completely separate company to receive the fee. The fee our customers pay is for service not directly related to the procurement of insurance. What our customers are actually paying the fee for is the compilation of a confidential file containing all the information that would normally be used for the underwriting of a life insurance policy. Once the information file is complete, the customer authorizes its release and it is forwarded to the insurance company along with an application. Upon issuing the policy, the insurance company mails it to us for delivery to the customer.

The brief description I have just given presents only an overview of the salient points and, naturally, omits many details as to exactly how our operation works and perhaps more importantly, why it works.

To summarize, though, Discount Insurance Service is not just a different kind of insurance agency. It is a totally new concept, and marks the beginning of a completely new philosophy in the marketing of individual life insurance policies. Customers who do not need a conventional agent to persuade them to buy are able to purchase what is essentially wholesale life insurance through the payment of a one-time fee, at the point of purchase. The overall result of delivering insurance protection in this way is a substan-

tial savings to the consumer. This is partly due to the fact that we have been able to set our own fee at a level which is below what a typical commission might have been on comparable conventional policies.

I have supplied for the record an illustration of how significant the potential savings can be.

[The illustration follows:]

Illustration of Potential Savings

PREFACE

The following illustration must be considered with two very large caveats in mind. First, it was prepared on short notice and therefore should nto be relied upon to be strictly accurate or absolutely complete. Nevertheless it is a prudent attempt to present a fair picture. Second, the policy example to which I have compared ours does not exist. To my knowledge, there is presently no conventional policy with design features of sufficient similarity to make a direct comparison. Therefore, I literally had to "create" a hypothetical policy by taking the most similar one I could find and "modifying" its rates to show only the difference resulting from fee-based marketing as opposed to commission-based marketing. Since I am not an actuary or an accountant, my "modifications" should only be considered an approximation.

SIGNIFICANT DESIGN FEATURES OF OUR POLICY

Fifteen years select/ultimate rate structure; nondistinct rates as regards smoking; pure term, not "graded premium whole life"; and not revertible.

OTHER DESIGN FEATURES OF OUR POLICY

Age last birthday; $100,000 minimum ($50,000 as spouse rider); unisex rates; not banded; indeterminate, nonparticipating; $25 policy fee; issue ages 25 to 75; and renewable to age 99.

The policy that I have chosen as the basis for my hypothetical comparison policy is the Annual Renewable Term (form 386) sold by Inter-State Assurance Company of Des Moine, Iowa. I picked this example because it is one of the few policies now being sold that has select/ultimate rates, is not promoted as a revertible, and is pure term insurance.

There are three significant points that must be kept in mind:

1.) The Inter-State policy is based on a 10 year select period while ours is 15 years. Not being an actuary I am not qualified to adjust the rates to make them exactly comparable to ours but the difference should not be significant.

2.) The Inter-State rates are segregated into smoker and non-smoker. Since there are approximately 2 non-smokers to each smoker in the general population, I have created the hypothetical comparison policy rates by adding two times their non-smoker rate to their smoker rate and dividing the sum by 3. Therefore the "rates" I show as "Brand X" are actually not real rates but rather are my "re-integration" of Inter-State's segregated rates. These numbers, however, can be considered to approximate what a smoker—nondistinct version of the Inter-State policy might look like.

3.) My comparison is for age 35 and $200,000 of coverage. Other ages and amounts may not produce the same comparative results. However, since this is a typical sale, it is a valid example to use.

$200,000 POLICY AT AGE 35

Year	"Brand X"	D.I.S.
1	$381	[1]$485
2	413	271
3	447	311
4	487	355
5	525	403
6	581	455
7	639	511
8	703	571

$200,000 POLICY AT AGE 35—Continued

Year	"Brand X"	D.I.S.
9	781	637
10	863	709
11	941	787
12	1,017	871
13	1,103	961
14	1,197	1,057
15	1,295	1,159

[1] D.I.S. first year cost of $485 is made up of $235 of premium, $190 of fee and $60 of expenses.

CUMULATIVE RESULTS

Year	"Brand X"	Savings	D.I.S.
5	$2,253	$428	$1,575
10	5,820	1,112	4,458
15	11,373	1,830	9,293

Mr. BOWERS. Since the comparison is a bit involved, I won't discuss it at length at this time. I will only call your attention to the last page. You can see that for a $200,000 policy issued to an individual who is 35 years old, the savings over a 15-year period might amount to over $1,800 or about 15 percent. I want to point out that the hypothetical policy against which I made this comparison is far better than most coverages now being offered by the industry in general. As compared to a more typical example, the savings would be much greater.

As you might expect, a potential buyer should be happy to see numbers like these. In fact, it is my extreme pleasure to report that during a period of test marketing a few months ago, the response was overwhelmingly favorable, and I have every reason to believe that Discount Insurance Service is going to be a huge success.

The fact that no one else has ever done this, and the fact that I had to work on this project for over 2 years before we were able to begin operation is due in large part to existing regulations and laws such as antirebate. In order to accomplish my goal of marketing life insurance at a lower cost, while at the same time complying with the law, it was necessary for me to spend a great deal of time and money on the development of a somewhat cumbersome procedural system.

Had there been no such thing as antirebate laws, Discount Insurance Service might never have come into being. That is to say, someone else surely would have done it long before now. If antirebate laws are rendered ineffective by passage of the legislation now being offered by Congressman LaFalce, there can be no doubt that the agency system will become more cost efficient, and that alternative distribution methods will be developed.

I do not speak as a theorist. I speak as one with 12 years of active experience in marketing life insurance. Antirebate laws, as well as laws prohibiting the direct charging of fees, clearly act to inhibit competition and therefore are not in the best interests of consumers or the free market system.

Mr. LAFALCE. I thank you very much, Mr. Bowers.

I want to ask just a few questions of both of you.

Either of you might respond to these first few questions.

What are your views on the insurance industry's claims that commission deregulation would only lead to higher insurance costs for the average consumer?

Mr. REGAN. My own personal feeling would be to disagree with that. I think by and large it would lead to lower costs for the average consumer.

Obviously we all can easily visualize lower costs for the large volume buyer, but, of course, to a degree that is already possible through the banding or the volume discounts, which right along with that volume discount to the buyer, is also a volume commission cut to the seller on most of those products.

I think generally speaking, when there is an opportunity to pass on a savings most people are going to pass on that savings, are going to find methods for selling more product to give them the same income flow that they needed yesterday to support that standard of living, overhead, and so forth. That is human nature, I believe.

Mr. LAFALCE. Any additional comments, Mr. Bowers?

Mr. BOWERS. Well, I think the idea that allowing more competition would increase costs is absurd. I think that antirebate has served to inhibit competition. I think removal of those laws will serve to stimulate competition.

I suspect though, that simply the removal of antirebate laws would not in and of itself result in any dramatic change the overall price of insurance products or the delivery system.

I think what would happen, though, is that the removal of antirebate laws would foster other distribution methods.

I think in response to the removal of antirebate laws, commissions, or rather agents, would, in fact, compete by rebating their commissions.

Companies that wanted to be competitive, if they wanted to prevent agents from rebating commissions, could simply design lower commission policies. Agents that then marketed lower commission policies would not have to rebate and the overall price of their products would be lower than the price of products where agents are rebating a portion of the commissions.

Mr. LAFALCE. And they would be free to charge for services rendered?

Mr. BOWERS. That is precisely the point.

Mr. LAFALCE. Let me ask you both a question then. I have entitled this the Insurance Sales Deregulation Act, not the antirebate law.

Let's suppose that the antiregulation concept prevails. I think we should say suppose the antirebate law prevails. Which in your judgment would be more likely to prevail, discounting and net pricing or some form of rebate system?

Mr. REGAN. Discounting and net pricing.

Mr. BOWERS. I think without a doubt rebating would perhaps ultimately inject into the problems the consumer faces in trying to make a decision, might interject more confusion.

I think antirebating, the repeal of antirebating would almost immediately lead to the development of net cost prices, net cost products.

I think therein lies the real benefit.

Mr. REGAN. Rebating itself would simply be confusing, quite frankly.

It is where that step takes you, really.

Mr. LAFALCE. Let me follow that up then.

Some individuals are saying that commission deregulation would frustrate industry attempts to design an effective and accurate method of cost comparison of policies.

Would you comment on that?

Mr. REGAN. My feeling, which I expressed in my written testimony, would be 180 degrees the reverse of that. I believe it would simplify cost comparisons.

Any time that you remove one more wild card from the equation, you simplify a comparison process, not complicate it.

That seems by its very definition to be the truth.

Mr. BOWERS. I think there is some truth on both sides.

Again, I believe my answer would have to be very similar to the answer to the previous question. That is that with so many different policy forms already, and so many different commission structures, to bring into that equation different rebates from different agents would serve to confuse it.

But, for the industry to say that this would be a detriment overall is again absurd, because the simple solution to that would be to develop net cost products and thereafter the comparison of one policy to another would be infinitely simpler.

Mr. LAFALCE. Commissioner Mitchell made a point that current marketing systems puts insurance buyers at a greater disadvantage than in a deregulated market because the current high commission policies that benefit the agent are not necessarily the policies of greatest value to the buyer.

What is your opinion on that thesis?

Mr. REGAN. There certainly are some examples of that being the case. I do feel in all fairness, however, that there is less and less of that today contrasted with what we had 5 or 10 years ago.

There are still some companies that pay a significantly greater percentage of commission on a whole life versus a term product in that same company.

Mr. LAFALCE. Could you make some comparisons?

Mr. REGAN. I think the numbers that were bandied around before are certainly representative. It may be 30 percent, 35 percent for a term product with company A. Company A's whole life product might be 50 percent. If it is a New York company, it is 55 percent plus expense reimbursement allowances. It may be much closer to 70 percent.

Mr. LAFALCE. Isn't New York lower than most States?

Mr. REGAN. Yes.

Mr. LAFALCE. Is that fairly exceptional?

Mr. REGAN. New York has a maximum commission of 55 percent on their whole life products.

Mr. LAFALCE. Any other State have a maximum commission lower than 55?

Mr. REGAN. Not that I am aware of.

In fact, I would say unequivocally no. I don't believe any other State even has a maximum.

New York is an extraterritorial law so you must observe their laws in every other State if you wish to be able to sell in the State of New York.

But, yes, there certainly are still examples of that where company A's term product might be a 30-, 35-percent commission; on a whole life product 55 percent.

There is much, much less of that today than there was in the past. More and more today the percentage of commission applicable to a term sale in the same company is akin to the percentage of commission applicable to a whole life sale.

Obviously you could say yes, but the whole life premium is greater. However, in most cases price—rather face amount or type of insurance is not the barrier, price is a barrier.

Therefore, someone will buy 200,000 term for the same money they would have spent for 20,000 of whole life.

So there's less attempt by the manufacturer to coerce their captive agents into selling a whole life versus a term product, but it does indeed still exist.

Mr. LAFALCE. Not as bad as before, but still is there?

Mr. REGAN. Definitely not as bad as before. Dramatic improvements have been made by the companies in that area.

Mr. LAFALCE. Mr. Bowers?

Mr. BOWERS. I don't think I can add anything further except to point out in discussing the commissions regulated by New York Code section 213, that the 55-percent commission is really not all that a New York company provides to its agents.

It provides direct expense allowances which are frequently expressed as a percentage of premium or a percentage of commission, which is again a function of premium; and the total payout to a New York agent or New York company's agent is typically not too far out of line with every other company whether they are in New York or not.

Mr. LAFALCE. Mr. Regan, what do you say about that?

Mr. REGAN. Most definitely. That is what I said before; 55 percent is the stated commission. With these reimbursable expense allowances——

Mr. LAFALCE. When you said it though, I was under the impression that since it was an expense allowance it would be for actual expenses.

Mr. REGAN. Well——

Mr. LAFALCE. Mr. Bowers said it is very often a percentage of commission?

Mr. REGAN. But you do have to voucher it. You can figure out a way to do that. Most companies are rather strict on vouchering. Obviously that is pretty simple to do.

Mr. LAFALCE. So you have given me new information, Mr. Bowers, about percentage.

Mr. Regan gave me new information about the vouchering.

Mr. BOWERS. Absolutely. The expense allowances are vouchered, those expenses not paid directly by the company.

For example, a New York company may, in fact, pay the office rent. That is perhaps not a voucherable expense. I am not privy to all the expenses.

Mr. LaFalce. I think the bottomline is basically the same?

Mr. Regan. Yes.

Mr. Bowers. Approximately.

Mr. LaFalce. I think on page 3 of your testimony, Mr. Bowers, you made a shot at the bottomline.

You did say that a normal general agency total commission is typically equivalent to 90 to 120 percent of premium in the first year?

Mr. Bowers. That is probably safe to say, yes.

Mr. LaFalce. How do you come up with that?

Congressman Marriott earlier challenged that. We have heard maybe 60 percent, 65 percent. How do you come up with 90 to 120 percent?

Mr. Bowers. Again, in adding in the—companies that do not sell products in New York can pay whatever they want and frequently the total general agency commission is expressed as a direct percentage and it may very well be 90 to 120 percent on some products.

It is not necessarily the same on all the products in that company's portfolio.

Companies that do business in New York express their commissions differently. It is a 55-percent commission, but then expense allowances, voucherable up to a given limit of an additional 35 percent.

So to say that 90 to 120 percent is rather typical is very accurate, yes.

Mr. LaFalce. All right.

Mr. Regan?

Mr. Regan. I would disagree slightly with that figure. My own personal experience would show that figure to be on the high side. Indeed, you might find a few companies paying over 100 percent in commission but those would be aberrations in the industry and not what I would consider the competitive products.

I would say on the competitive, term or cash value, cash products, you are looking more at a range of, say, 60 to 90 percent even at a general agent's commission level.

Mr. Bowers. Also one other comment: Included in my figure—and I say these are not uncommon; they are not by any means an average, but they are not uncommon. I think Mr. Regan will agree with that.

Included in that I would also put in other indirect forms of compensation such as bonuses, awards, persistency——

Mr. LaFalce. Let's talk about that.

Mr. Bowers. That sort of thing.

Mr. LaFalce. You say further "we." You are talking about discount insurance service now—"receive no other forms of compensation such as expense allowances, bonuses, awards, convention credits, or anything else."

Mr. Bowers. Yes.

Mr. LaFalce. You mean that insurance companies then do give bonuses, awards, convention credits?

Mr. MARRIOTT. So do banks.

Mr. LAFALCE. Do they give this sometimes because of the particular type of policy that you might sell as opposed to other types?

Mr. REGAN. In most cases it is just an overall production. Although one policy form, it might be counted different than another policy form.

Mr. LAFALCE. What do you mean by that?

Mr. REGAN. The whole life policy, regardless of what standard you are ever applying, is always counted at the very, very highest level.

Mr. LAFALCE. What might the highest level be? What might the level be for whole life and for term insofar as bonuses, awards, or convention credits?

Mr. REGAN. If we start with 100, then whole life is 100. You may go down to term counting as low as 15 percent of the face amount contrasted to 100 percent of the face amount for conventions.

That is, in fact, the way the Million Dollar Round Table's qualifications are determined.

It is 15 percent of the face amount on term insurance, so it takes $15 million of term to do $1 million dollars in Million Dollar Round Table credits.

Of course, term is pretty competitively priced today. It is easy to sell a lot of millions of that stuff, really.

Mr. LAFALCE. Would you care to add to that, Mr. Bowers?

Mr. BOWERS. No; I don't think there is anything I can add.

Mr. LAFALCE. Mr. Regan, on page 2 of your testimony I would be happy if you could provide me with a copy of your 600-page book and your new Consumer Buying Guide to Insurance.

Mr. REGAN. OK.

Mr. LAFALCE. Dan, those are the only questions I have at this time.

Mr. MARRIOTT. Thank you. I never thought I would see the day when the insurance industry would be in here discussing rebates and telling us why rebates are good, but if I understand what you are saying, I think you are saying the same thing I am saying.

I have no opposition to discussing fees for services, having a net cost of insurance, and adding your own fees based on what you can get in the marketplace; but, there is a difference in that and in playing games with rebating. If I understand you, Mr. Regan, you are saying that the only reason you like Mr. LaFalce's bill of allowing for rebating is because it might lead to this other scenario?

Mr. REGAN. I certainly would view it as a step in the right direction. But to come back to your earlier statement, I think that the feeling is not so much that we have to get to a fee for service, although it is certainly where some people in the industry are headed and some of the best minds in our industry have been accumulating time logs on all their corporate accounts for a number of years now with the idea in mind it is going to a fee for service approach.

But, more than that, I guess what I am saying to synthesize is to put the control of negotiation in the hands of the person on the firing line rather than in the manufacturer's hands, which is where it rests today.

Mr. MARRIOTT. Are you related to Bill Regan?

Mr. REGAN. Only because of the fact our offices are about a block and a half apart.

I know Bill very well.

Mr. MARRIOTT. As an insurance agent, don't you see some problems with allowing for rebating? Let me explain my question:

In the clientele I worked, I would have preferred a policy with no commission which allowed a fee, no question about it. If you are in the big leagues in insurance, that is the way to go.

If you are dealing in corporate insurance, buy/sell agreements, and other things, I can argue that for the successful, sophisticated salesman, he would probably prefer that way.

That is not rebating, because on rebating you cap the commission.

I guess you can say we are going to allow rebate and allow fees on top of that. It doesn't make sense to me.

But, for the typical mom and pop producer, and there's 1,000 of them out there for every big hitter who is right in the Million Dollar Round Table; there are a 1,000 people out there struggling to make a living, correct?

Mr. REGAN. Right.

Mr. MARRIOTT. They are selling to mom and pop, unsophisticated insurance buyers.

Don't you believe that rebating per se, forgetting this other concept, is going to be harmful and detrimental to that market?

Mr. REGAN. I think if we are looking at precisely the way the products are structured today; and if at the snap of a finger in the next moment we would have rebating legal on the product line as it is structured today, that would indeed cause some confusion in the marketplace.

I don't know personally—the term "rebating" doesn't feel good to me because of my background in the insurance industry, but the idea of being able to negotiate the deal between a willing buyer and a willing seller certainly does appeal to me.

Mr. MARRIOTT. If that is the case, then there shouldn't be a set, arbitrary commission to start with, should there?

Mr. REGAN. You can say what that set arbitrary commission is, I suppose, is a suggested retail price. The only reason that rebating itself in its purest sense—and of course that is what we are talking about here—you know, might produce some confusion in the marketplace is because of the fact that on a particular policy, you might have a 100-percent load the first year, maybe about a 90-percent commission the first year, and so you say, well, OK, how does the consumer really measure that product against another product that had a 30-percent load feature for 3 years which you marked down?

But I don't think that the problem or the confusion that might be created by taking what we are talking about in its purest sense and making it law tomorrow, if that were indeed the case, would actually take place, because I do feel that the insurance industry, as staid, conservative, and slow moving as they are, would have the ability to react to that change by just a slight modification of product.

Mr. REGAN. We would get to where we are probably going anyway, which is level type of casualty commissions 5 years from today.

Mr. MARRIOTT. Let's talk about the agency system.

What you are talking about is fine and dandy if you are a highfalutin broker down the street, and you make deals with insurance companies anyway, and you don't deal in subsidies or training allowances, nor are you a new trainee just off the street.

I would guess a big chunk of insurance, is sold by the new people who come in; they are on some type of a subsidy, and they are on a commission scale. They are employees of the insurance companies per se.

Would going to this system basically destroy the agency system as we now know it?

Would that destruction be a little premature at this point?

Mr. REGAN. My own feeling—this is just a feeling, not a fact—is it is inevitable anyway.

I think it certainly would be a step in that direction which again, my personal feeling is that would be an extremely positive step for the consumer to have the consumer represented by people who were not legally and contractually bound to represent one company's products.

I don't think there is any manufacturer in any field, whether it is appliances, or suits of clothes, or insurance, that can have the best product for all situations at all ages at all durations at all sizes, styles, and so forth.

So if indeed that were to be a byproduct of what we are talking about here, my own personal feeling is that that would be an extremely positive byproduct.

I think there is an alternative to the agency distribution system.

Mr. MARRIOTT. You believe that with the destruction of the agency system, as certainly would happen under this, you would be willing to drive 30 miles out in the country to sell a $10,000 ordinary life policy to Ma and Pa Kettle and negotiate the commissions?

Mr. REGAN. I believe I could have someone on my staff that was on a salary working for me on an account executive basis. Let's not think just about life insurance and the distribution of life insurance as it exists today, because everything does not always have to remain as it is today in any field.

Changes are inevitable.

Let's look at other comparable distribution systems, that is, the casualty distribution system.

How are new people brought into that? They are brought in as employees on a salary by those houses. Guess what?

They actually even learn something before they go out there and have to make a nickel by selling a policy. They might have started——

Mr. MARRIOTT. Is that an indictment of the life insurance industry?

Mr. LAFALCE. Much more modest than the one that you made.

Mr. REGAN. It certainly could be characterized as such, yes.

Mr. MARRIOTT. Let me ask Mr. Bowers.

Under your illustration of a $200,000 policy, if a policy owner bought your policy in the first year, you have got a $235 premium and you have tacked $190 as a fee on top of that and $60 expenses on top of that.

You are charging $485?

Mr. BOWERS. That is correct.

Mr. MARRIOTT. That is a worse deal than he could have had under brand *x*. In the first year, is it?

Mr. BOWERS. Forgive my brand *x* as an attempt at humor here.

You will note anything overspent in the first year is made up very quickly in subsequent years.

Mr. MARRIOTT. The reason I say that is, I just had my staff run out to get some premium rates. Here is a policy where we have no fees, no expenses added, and it is a lot better deal than brand *x*.

For example, the premium the first year is $212 for $200,000.

Mr. BOWERS. Could I ask who issues that policy?

Mr. MARRIOTT. I could not say at this point because I don't have that information.

The premium then grades up to about $800 in the 10th year, where yours is $709. But it seems to me you have to do a lot better than you are doing in order to justify that over the first 4 or 5 years of the policy.

Is this brand *x* a competitive company or just—First Colony is one of them.

Mr. REGAN. Select 20?

Mr. MARRIOTT. I don't know what it is.

Mr. BOWERS. I am very familiar with those products.

Mr. MARRIOTT. If a policyholder buys this policy in the first year and lapses it, he is worse off under your deal.

All this policyholder does all day long is look for the best premiums. I guess one could draw a conclusion that he may not be better served by having a so-called noncommissioned policy and a bunch of fees added on.

He will spend all his life paying fees.

Mr. BOWERS. That is right. That is absolutely correct, sir. That is precisely the point why mine is a better one for not only the consumer in general, but the particular consumer in this case, and society and the industry at large.

It is the very point you have just brought out. That companies are marketing products that are attractively priced and pay high commissions, and because of that agents go back and replace the business year after year after year after year.

Because of this the lapse ratios on new issued term-type business is atrocious. One out of five cases lapses the first year.

About 12 percent the second year, 10 percent the third year.

By the time a company actually gets to the point where it is breaking even, nearly half the business is already gone. That has to produce an extremely high expense loading that goes into the premiums that everybody is paying.

My whole point in designing this policy as it is is that any individual who buys this policy and lapses it, hurts no one but himself, and the two products you have mentioned, the Kemper SR 20 and the Select 20 from First Colony, are not anywhere near a comparative analysis.

I note you only quoted the first 8 years' premium. Would you please ask—or may I ask what the 10th, 15th, and 20th year premiums are, sir?

You will find also that those products are what are known as revertible products. If you want to continue to have a low-premium rate, you must supply new evidence of insurability.

That is entirely a different product.

We are talking about a comparison that cannot be made.

Mr. MARRIOTT. Who in the business now is underwriting no load policies?

Mr. BOWERS. The only company I know is the company writing ours.

Mr. MARRIOTT. Who is that?

Mr. BOWERS. Chesapeake Life, Baltimore, Md.

Mr. MARRIOTT. Do they sell ordinary life or just term?

Mr. BOWERS. The only product available now is term. That is the product we have. It was designed specifically for our organization.

Mr. MARRIOTT. You wouldn't, by any chance, sell everybody term insurance just to get a fee because there are no life insurance products competitive in this area?

Mr. BOWERS. I would sell term insurance to virtually everyone for other reasons besides that.

Whole life in my estimation is and always has been tantamount to consumer fraud.

In my estimation, virtually no one should have whole life to begin with. I would sell term to almost everyone in the first place.

Mr. MARRIOTT. And still get a whole life commission?

Mr. BOWERS. I certainly wouldn't call $190 commission on a $200,000 policy a big commission, sir.

Mr. REGAN. May I add to that?

Mr. MARRIOTT. Let me come back and say that my possible complaint is not that you would—your $190 is not anything to get nervous about, but it does open up all kinds of options, doesn't it?

It does open up the industry to any type of a fee you want to charge.

You could charge a $2,000 fee and the unsuspecting client may well pay it, if you were going to get enough sales.

Again, if you are going to go this route, it is going to require a more intelligent, more educated group in the insurance industry in my opinion.

If you don't, I don't think anyone in the long run is going to gain anything just by playing this game over the short run.

If people don't keep policies longer, wind up paying lower fees, lower amounts of money for the policy, wind up with better protection in the name of free enterprise and competition, you made a few people richer and a lot more people a lot unhappier.

I think this is going to require some type of policing, is it not?

Mr. BOWERS. Well, I don't think there is a necessity for policing. Obviously no one is going to buy the same product across the street from my office and pay a $2,000 fee for precisely the same product when I am going to sell it for $190.

I think that is completely absurd.

Frankly, I somewhat resent the implications that you have made about the possibility of our taking advantage of people. The fact

that people are buying what I have characterized here as brand *x*—and you will note in my preface that that policy really does not exist; it is a hypothetical policy that I had to literally create out of one that was similar to ours, there are really very few examples that are similar.

You will note that over the long run even by the third year the difference is considerable savings in favor of the product that we are marketing.

To say that it is in the consumer's best interests to pay less the first year and thereby have a product which is heavily loaded to cover potential losses due to lapsation, a loading, which he is going to bear for as long as he keeps the policy, is ridiculous.

The policy that we have, the premium that we market, is lower than anything of comparable value in the marketplace today; in fact, in the history of the insurance industry. What we are doing is marketing a pure net cost product with up front, full disclosure, and anybody going into it is going in eyes open.

The product will be advertised. We don't expect this will appeal to everyone. We expect that people with a greater understanding of financial matters in general and particularly insurance are going to respond to that.

Market research has clearly shown that people would prefer to deal with professionals on a fee basis.

So, we think it is a trend that is going to continue. The obstacles are going to fall. What we are doing, I think you are going to see a whole lot more companies doing in the very near future.

Mr. REGAN. A couple of quick add-ons to that last answer.

First of all, there have been net priced cash value as well as term products and there are other companies in addition to Chesapeake Life that are offering net term product today.

Second, I would certainly disagree with the statement made here at the table insofar as in almost every instance selling term insurance. I think that going back to my statement earlier that the insurance industry has resisted change successfully for far too long, they are now changing. The product lines are becoming very, very competitive, very attractive. There are some extremely good consumer oriented permanent insurance products which stack up very, very well indeed with alternate savings vehicles.

Third, I think what we are really maybe talking about is not whether or not his discount term insurance or term insurance for a fee is the right solution for you or for any other particular consumer out there. I think maybe what we are really talking about is why should we be afraid of any competition.

That is what we are really talking about. Why do we need to fear competition? Why do we need to fear his approach?

I may not agree with his approach. Why do we need to fear it? Why do we need to block it?

Mr. LAFALCE. I will give the gentleman 1 more minute.

Mr. MARRIOTT. I think there is plenty of competition right now; why are we fearing what is going on right now?

There is not an uncompetitive life insurance industry out there, by far.

Mr. REGAN. No; but the insurance companies are setting the rules.

Mr. MARRIOTT. The insurance company commission scales go all over the place. Their premiums go all over the place. Their benefits go all over the place.

The only point I will conclude on is this: That the whole reason for this hearing is to protect the consumer. That is why we are here, to protect the consumer. My guess is that in the long run—even though I personally like the idea of tacking fees onto insurance policies—I can make more money that way—my feeling is in the long run we may not be protecting anybody.

I think that is something that has to be studied, looked at, and analyzed.

I think the companies will get competitive as they are right now.

I think the whole thing needs to be looked at. I am against wholesale rebating law changes until we understand the industry.

Mr. LAFALCE. I think we are going to have to bring this to a conclusion.

I have allowed the questioning by Congressman Marriott to go on for approximately 20 minutes when the norm is usually 5; I allowed more because I considered the dialog to be interesting and I think basically helpful to the cause.

I would point out that nowhere in the bill that I have introduced can the word "rebate" be found. We are simply allowing the deregulation of the pricing of insurance and we are allowing the marketplace to work its will.

I would also make this observation before concluding: Mr. Bowers, I think you made—both of you made—outstanding presentations, but one point that you made, Mr. Bowers, was that there will undoubtedly be some difficulties in transition, to be sure.

I think whenever you deregulate, you have transitional difficulties, whether it is the deregulation of the airline industry, or the trucking industry, whether it is the deregulation of the banking industry, but I think deregulation is a concept whose time has come and whether you are Ralph Nader or whether you are the Heritage Foundation, I think the concept of deregulation for every industry is one that should be examined.

Unless one can show why one industry is so unique, then I think the arguments are rather compelling. We are going through difficulties in the financial community right now because of the fact that we had regulation for so long on the books and we only allowed banks to charge 5½ percent.

It was easy to be a good banker then. You were guaranteed a spread. We deregulated. It is to the advantage, in my judgment, to the consumer, to the saver.

He is getting now, and will get, a much higher rate of return on his savings. That is not to say that we aren't experiencing transitional difficulties.

We will survive the transitional difficulties. The institution will not, the financial community will not survive in the same manner. To be sure, the thrift industries will have to learn to adapt. They will have to change. They might need additional powers, but I am reminded so much of the story of the dinosaur that could only exist in one environment and one environment alone; and when that environment changed, the dinosaur became extinct.

It seems to me that what we ought to try to do is make sure that we do bring about change in an appropriate manner, so that the insurance industry can thrive and the consumer can prosper, and I don't think that the insurance agent is going to be extinct at all.

I think that, as the broker for Merrill Lynch and Bache have not only survived, but prospered even more under deregulation, the same is going to be true of the good insurance agent.

We will adjourn until 2:15.

Thank you.

[Whereupon, at 1:45 p.m., the subcommittee was recessed, to reconvene at 2:15 p.m., the same day.]

AFTERNOON SESSION

Mr. LAFALCE. The Subcommittee on General Oversight will come to order.

We will resume the hearings we adjourned this morning.

Our first witness this afternoon will be Dr. William Scheel, professor of insurance, from the University of Connecticut.

TESTIMONY OF WILLIAM SCHEEL, PROFESSOR OF FINANCE AND INSURANCE, UNIVERSITY OF CONNECTICUT—STORRS

Mr. SCHEEL. Thank you, Mr. Chairman.

DISCLAIMER

I am William C. Scheel, associate professor of finance and insurance, University of Connecticut—Storrs.

I am the author of several monographs and numerous articles, many relating to life insurance cost disclosures and the informational needs for competitive life insurance markets.

I have been a consultant to the National Association of Insurance Commissioners on life insurance cost disclosure and to the Federal Trade Commission on debit life insurance.

I recently was a member of the NAIC advisory task force on life insurance manipulation.

I am not being compensated for testifying at this hearing. My comments on insurance antirebate laws reflect my own views and may be shared only coincidentally by other people or organizations.

THE SCOPE OF THE ATROCITY

There are at least 3.4 million small business establishments with 50 or fewer employees.

The annual insurance purchases of these firms in 1978 were estimated to be $24.8 billion.

I conservatively estimate commissions to be 5.6 percent of this total or $1.39 billion. Were agents to be allowed to rebate, small businesses would probably have received rebates well in excess of $37.5 million during 1978.

When all insurance purchases are examined, the loss foisted on U.S. insurance consumers by protectionist State antirebate laws was a staggering $258.6 million during 1979.

This State-sanctioned atrocity cost my fellow Connecticut consumers an estimated $3.722 million in 1980 alone. The breakdown

of both the United States and Connecticut costs is shown in tables 1 and 2

Apparently there are few Darwinians within the insurance community willing to reward efficiency when it means the eradication of weaker protagonists.

Like creationists, wedded to beliefs empirically unprovable, State insurance regulators cling to many indefensible laws—laws conceived to solve a problem but boomeranged wildly so that the public is worse off with their continuation.

Nothing characterizes this nefarious behavior more than insurance antirebate statutes.

REBATING SAVES INDUSTRIES AND SELLS FIGS

Rebating—a return of part of the price of a product—is an inducement to buy. It has been used successfully by all car manufacturers to save the U.S. automotive industry during periods of slack sales.

Rebating is used to push toothpaste, TV sets, savings accounts, photography film, and figs. Bargain hunters can clip coupons and enjoy the time-honored promotional gimmick of rebating. It is second cousin to haggling and is the mainstay of marketing in all industries.

Retail price-fixing is the required way of selling all forms of insurance.

Insurance agents are compensated by commissions on premium income on the policies they sell. The remuneration usually is a fixed percentage ranging between 13 and 18 percent of every premium for auto and homeowners policies to much higher percentages during the first year for life and health insurance.

It is not uncommon for life insurance agents to earn 55 to 75 percent of the first premium payment on conventional life insurance policies. Money to bargain with? Seemingly, yet an agent may not entice sales by offering a portion of commission income as rebates. . . .

There are many small business insurance transactions involving substantial commissions.

About 18 percent of business life insurance involves annual premiums in excess of $3,000.

This is just one type of many different insurance policies purchased by a small business. Very high first-year commissions can be earned by agents on these plans.

For example, one agent in southern Connecticut earned $3,147 when he sold a Security-Connecticut $200,000 whole life insurance policy to a 46-year-old male. The premium was $4,842. The 66-percent commission was followed by 5-percent commissions at each renewal of the policy. The sale required several phone calls and a closing interview with much of the detail work handled by third party legal counsel.

The agent believes that many sales like these warrant some form of rebate to the consumer. But he is constrained in making this moral commitment by the Connecticut insurance commissioner.

In addition to direct compensation, many general agents receive additional remuneration in the form of persistency bonuses, service fees, and override commissions.

It is not uncommon for the first-year commissions to the general agent and the producing agent to total 90 percent of the premium.

Although many inefficient agents or agents who purportedly are full time, but in fact work only part time, earn low incomes, there are some whose efficiency and productivity permit a return of part of the commission as an inducement for further sales.

State antirebate laws remove the incentive for agents to streamline their marketing methods. Instead of encouraging survival of the most productive agency operations through competition, State insurance commissioners sanction an operating environment where inefficiency and low productivity can fester.

Ironically, this calamity occurs in the presence of laws directing insurance commissioners to monitor and maintain competition in most insurance markets.

Many States define insurance rebating as an unfair trade practice. The Connecticut statute also makes acceptance as well as offering of rebates illegal and subject to penalties of up to $5,000 for each violation. Agents knowingly violating the antirebate law are subject to suspension or revocation of their licenses.

Even with these legal barriers to rebating activity, Carlyle Buley, an insurance historian, noted:

> Rebating, like sin, showed remarkable powers of survival. At more or less regular intervals everyone swore off . . . and then quite to everyone's surprise, there it was still, a dirty but rugged brat, nobody's in particular, not even conceived in sin and inequity—just a sort of spontaneous conception of the industry.

SWEET DIVIDENDS AND SOUR REBATES

The mutual theory of insurance is the cornerstone of most life insurance and substantial amounts of property, liability, and health insurance.

Ironically, it is tantamount to legally acceptable rebating, although in theory it is not designed to be an inducement to buy.

The principle is simple. Insurance involves accumulation of funds from many sources and payment only to those unlucky few sustaining losses.

An insurer can never know precisely the size of the monetary pool needed to cover losses. Insurers conservatively collect excess funds, adequate to cover losses and still leave ample surplus.

The principle of mutuality argues that the cost of insurance to buyers should be adjusted through rebates, called policy owner dividends, so it is sold on a fair and equitable basis.

THE MANY DISGUISES OF REBATE

The return of profits in the form of policyowner dividends are legal rebates. They even constitute a form of tax shelter, yet the return of profit earned by an insurance agency is an illegal rebate.

There is question whether rebates would be a deductible business expense to the agent.

The guise is similar, but the consequences are perversely different.

Although policyowner dividends are not designed to be an inducement to buy and are not even guaranteed to be paid, in practice they may operate in this fashion.

Promotional gimmicks can also be illegal rebates. Reciprocity offered by an insurance agent in the form of reduced rents for a client's office space is an illegal rebate.

An agent will be reprimanded by the insurance commissioner for illegal rebating when selling stocks or bonds at a price reduced by the amount of a proposed rebate on a tie-in sale of securities and a policy.

Advisory board compensation for an insurance client who pays the premium less a fee for some fictitious service rendered the agent is an illegal rebate. Payment to insurance clients for referrals is illegal because it constitutes a rebate.

Binders offering temporary coverage until a policy can be issued but with no premiums collected are illegal rebates.

WHY REGULATION?

The framers of antirebate laws apparently placed greater trust in the companies than in agents; company dividend practices today remain substantially unregulated, but agents are fettered by antirebate laws, replacement regulations and other limitations contained in solicitation regulations or prohibited as unfair trade practices.

The genesis of the antirebate laws dates to the late 19th century, a period dominated by the ravaging of the concept of mutuality and plundering of consumers by life insurance companies.

Insurers sold deferred dividend products, and great profit hoards were accumulated because dividends were paid only to policyowners keeping policies in force for long durations.

During the period agents' commissions increased over 16-fold from 5 percent to 80 percent of first-year premiums.

Inducements like high salaries, expense allowances, commissions, and production bonuses were tapped by agents for rebate activity. The deferred dividend policy combined with excessive rebating aroused public interest and indignation. Extravagance and corruption in the life insurance sector were inflamed by a product unique to this distant era—the deferred dividend policy.

The tontine remains to this day a sequestered devil. Antirebate laws were one of many reform measures, including a required annual distribution of profits, designed to mellow cutthroat competition and restore orderly markets.

The deferred dividend is now substantially dead.

Is there any continued need for the anti-rebate laws that were spawned by this now defunct product?

UNTYING THE ANTIREBATE KNOT

A recent legal challenge of antirebate laws occurred in Florida. The case was never adjudicated because the plaintiff agent died during the course of the proceedings.

However, his arguments favoring rebating were forceful. He contended that the way life insurance traditional products have been

packaged and the lack of consumer understanding about them have obstructed competition.

The percentage of premiums agents earn as commissions remains at about the same level today as existed when antirebate statutes were enacted at the turn of the century. These statutes caused fixed pricing of products at the retail level and monopoly pricing of agent remuneration.

But, in the presence of rebating, agent remuneration would bend to needed increased competition and consumer welfare through lower prices. Rebating would produce a system of remuneration similar to fee for service with larger percentage rebates going to consumers requiring fewer services.

Innovation and efficiency in the agency system would be rewarded; sheltering of low productivity and inefficiency would be eliminated.

Those of us favoring repeal of the antirebate statutes contend that repeal would reduce the agent's temptation to sell someone an inappropriate policy because it may have a more lucrative fixed commission. The development of alternative marketing strategies like a fee, instead of a commission, would be fostered. Instead of fixed commissions earned regardless of productivity, individual agents would have the opportunity to adjust compensation to competitive pressures and the efficiency of agency operation.

High productivity within the agency operation would pass savings to customers.

But most insurance people oppose repeal of the statutes earning a return to the abusive practices existing prior to the Armstrong investigation. They argue that consumers and agents emphasizing cost considerations would make decisions on the size of the rebate rather than the merits of the policy. Massive replacement activity could be induced by rebates. Unscrupulous agents might sell policies quickly and not stay around long enough for the service needed later on. Some consumers could receive an unfair advantage. Sophisticated consumers and those paying high premiums would be able to negotiate larger rebates than the average consumer. Because of excessive competition among agents, commission levels would climb enabling even larger rebates and pushing insurance costs into a spiral benefiting only a minority of buyers. In my judgment, these fears are unwarranted.

Commonsense tells us that rebating would create competition. Arguments against it alleging favoritism and discrimination by agents among buyers are specious. High volume sales have economies of scale at all levels, company and agent. There are fixed and variable acquisition costs. A streamlined and efficient agency should be able to identify significant economies. This type of efficiency should be reflected in lower unit costs to buyers just like a grocer can offer a better unit price to the purchaser of a whole carton of peas than to someone buying them by the can.

The bargain that can be struck between buyer and seller should be sensitive to competition.

Fixed retail pricing has fallen in one deregulatory action after another. Industries ranging from consumer durables to transportation and securities sales have joined competition. Economists believe fixed pricing rarely benefits consumers. Now is the time to

87-363 O - 82 - 5

end the insurance antirebate atrocity. Rebating will force many marginal agents who are presently subsidized by fixed price supports to abandon their business. But the slack will be picked up quickly by efficient marketing systems.

In the end, consumers will benefit through lower costs and innovative service stimulated by greater competition; $259 million is a pile of money. Let us now begin the process of giving it back to consumers. They should be as euphoric over the investigations of this committee as I am.

It marks the beginning of the end of three-quarters of a century of atrocity. Competition can bring new vitality to this lethargic industry. It is assured with the demise of antirebate laws.

I would be pleased to answer any questions.

Mr. LAFALCE. Thank you very much, Dr. Scheel. We will have a few questions.

Because of the time, a quarter to 3, we are going to confine ourselves and all other members of the subcommittee or committee to the 5-minute rule.

Dr. Scheel, what is your response to the position taken by the National Association of Life Underwriters that since the premium rates are set by the insurer, then the insurer is the only party capable of determining what would be an appropriate discount of the agent's commission?

Mr. SCHEEL. We have been talking about the so-called net cost pricing today. I believe that you have struck perhaps at the heart of an issue. That is, will net cost pricing be done in the presence of rate regulation or in the absence of rate regulation?

I presume that the role of an insurance commissioner, who is given the charge of assuming that insurance markets have neither excessive rates nor inadequate rates and certainly fair rates, would continue even in the presence of rebating.

I would assume that as is the case in the property liability area, much prior rate approval would continue to exist. I would argue that it is the insurance commissioner, not the insurance company, who will make the final decision as to whether a rate is fair or not fair and that that prerogative will remain with the insurance commissioner even in the presence of antirebate activity.

Mr. LAFALCE. Fine. One industry witness suggests that enactment by the States of the NAIC model Unfair Trade Practices Act constituted a review and also an impressive reaffirmation of the principles underlying the antirebate laws.

What would your assessment of that be?

Mr. SCHEEL. Would you repeat the first part?

Mr. LAFALCE. An industry witness suggests enactment by the States of the NAIC model Unfair Trade Practices Act constituted a review and an impressive reaffirmation of the principles underlying the antirebate laws.

Would you agree or disagree with that assessment of the States' activities in this area?

Mr. SCHEEL. I don't believe it constitutes a reaffirmation. I am not sure that we necessarily want to connect the rebate statutes with any provisions that might be involved in unfair trade practices.

In fact, some States even put antirebate statutes in separate sections of their code.

So I am not sure that we can say that there is a reaffirmation there. I think that the spirit of what we are trying to get at here is that agents will be held to a standard of conduct of professionalism. The problem, as I see it, with rebates is the extent to which that professional conduct may be persuaded one way or the other to be inappropriate.

Mr. LAFALCE. Speaking of conduct, if I might interrupt the thought, because you are getting to a very important point, who does the agent represent? The insurance company or the potential buyer?

Mr. SCHEEL. The insurance agent represents primarily the company, since the agent is being compensated through commissions paid by the insuror.

Mr. LAFALCE. Does that response apply to the independent agent as well?

Mr. SCHEEL. Sure.

Mr. LAFALCE. Does the buyer not believe that he is representing him?

Mr. SCHEEL. I think most buyers would prefer to believe that the agent is representing the buyer, but I doubt if many buyers are so naive as to perceive that that is indeed the case.

If you look at public opinion polls, I am not sure that your friendly agent is the most trusted person in the world.

Mr. LAFALCE. Is the same true for a broker?

Mr. SCHEEL. Brokers are presumably representing the client more directly. I personally don't feel that there is a shred of difference, however, in their true allegiance.

I think a broker and an agent hold their primary allegiance to the competitive markets in which they work, but must consider their form of compensation.

Mr. LAFALCE. Is there any code of conduct regarding the hats that one wears in representing a potential customer and representing a company and the disclosure that one should give of the hats that one wears?

Mr. SCHEEL. Well, if you are suggesting that commissions be disclosed——

Mr. LAFALCE. No. No. Not just commissions, but the relationship that exists. So often an individual will represent himself as giving personalized insurance service, customed to your needs, independent advice and insurance counsel, and so forth.

Yet that person is basically a representative of a number of insurance companies. It just seems to me there is an inherent conflict.

I am sure that there are ways that insurance agents and brokers resolve that conflict, but I am just wondering what it is, and if there is a code of ethics?

Mr. SCHEEL. Professional agents that have attained designations in their field do, of course, ascribe to a code of ethical conduct. It presumably would cause them to conduct themselves more directly within the interests of the buyer. But do they really ascribe to ethical behavior and indeed conduct themselves accordingly?

I think it would be impossible for me to make an assessment of whether the average agent is performing in a manner directly benefiting in all ways the position of a client because, were I to respond to that, I would also have to respond to the issue as a 90-percent first year commission such an incredible inducement that even a professional person would look more to it than to the code of conduct.

We are dealing with things that we really cannot assess directly, and I am not sure that they are germane to the basic issue which, as I understand it, is the manner by which agents are allowed to conduct their business. That is what we are really talking about.

That includes all manner of association, all manner of design, that they might conceive of to foster that business and to develop it.

Yet we see antirebate statutes severely restricting the kinds of activities that these people can do, activities which, by the way, would be fully consistent with professional conduct.

Mr. LAFALCE. My time has expired.

Congressman Marriott?

Mr. MARRIOTT. Thank you, Mr. Chairman.

Doctor, as I saw you sitting over here, I thought you would be much quieter and come down on the side of the status quo, but I was certainly mistaken.

Let me just ask you this question: You are alluding on page 2 of your testimony: I take it that your analysis here is that it would probably be a good idea if insurance agents gave 50 percent of their commissions back to the consumer.

You are saying that in the absence of these laws, the $37.5 million would have gone back to small businesses.

Mr. SCHEEL. Yes. I am——

Mr. MARRIOTT. Where are you getting that figure?

Mr. SCHEEL. If you turn to tables 1 and 2, you can see my estimated rebate activity, both for the United States, and, in the case of Connecticut.

[Tables referred to during testimony follow:]

TABLE 1.—POTENTIAL INSURANCE REBATE ACTIVITY, UNITED STATES (1979)

Type policy	Premiums (billions)	Estimated commission (billions)	Rebate percent	Estimated rebate (millions)
Life:				
Ordinary:				
First year	$4.019	$2.291	3	$68.725
Renewal	22.100	.663	1	6.630
Industrial	1.320	.013	1	.132
Group	8.007	.240	3	7.206
Credit	1.786	.054	3	1.607
Annuities:				
Individual	4.976	.100	3	2.986
Group	12.963	.130	3	3.889
Health:				
Individual	6.081	.426	3	12.770
Group	20.838	.208	1	2.084
Credit	.975	.029	3	.878

TABLE 1.—POTENTIAL INSURANCE REBATE ACTIVITY, UNITED STATES (1979)—Continued

Type policy	Premiums (billions)	Estimated commission (billions)	Rebate percent	Estimated rebate (millions)
Property-liability:				
Commercial	47.630	1.429	5	71.445
Individual	40.100	4.010	2	80.200
Total	170.795	9.593		258.552

Source: Premiums—Life Insurance Fact Book and Insurance Facts. Other—calculations of the author.

TABLE 2.—POTENTIAL INSURANCE REBATE ACTIVITY, CONNECTICUT (1980)

[Dollars in millions]

Type policy	Premiums	Estimated commission	Rebate percent	Estimated rebate
Life (individual)	$402,956	$44.728	1.3	$0.581
Annuities	193.283	3.866	3.0	.116
Life (group)	162.586	4.878	3.0	146
Annuities	81.667	.817	3.0	025
Credit life	11.712	.351	3.0	.011
Health (individual)	46.956	3.287	3.0	099
Health (group)	336.794	3.368	1.0	.034
Property-liability (commission)	866.786	26.004	5.0	1.300
Property-liability (individual)	729.758	72.976	2.0	1.460
Total	2832.498	160.275		3.772

Source: Premiums—Office of the Insurance Commissioner. Other—calculations of the author.

Mr. SCHEEL. These are Scheel's estimates. Like any estimates, they are just that. There is no basis in fact as to just what extent rebate activity might be.

I think it will vary. I think that it may be as much as 5 percent of the commercial property liability lines, whereas it may be as low as 1 percent on renewal commissions in life insurance. In the case of group life and health insurance, you already find a great deal of de facto rebating going on.

Mr. MARRIOTT. Well——

Mr. SCHEEL. Because, of course, commissions are negotiated when a contract is unique.

Mr. MARRIOTT. It appears to me you are arguing throughout the first part of your testimony that insurance commissions are too high now, and, therefore, morally they ought to be returned to the consumer; is that the point you are making, or have I missed it?

Mr. SCHEEL. I am saying there are professional agents, agents that ascribe to the kinds of codes of conduct we have been talking about, that do feel a moral commitment to return commissions that effectively don't warrant the effort that went into transacting that sale.

Consider the example of the Connecticut agent where you involve yourself with a couple of phone calls, and one face-to-face meeting, but the work was largely performed by an attorney.

In that case there was a feeling of a moral commitment to rebate.

Mr. MARRIOTT. But we can't single out the insurance business alone in this area. If we get into this, we better get into law firms,

doctors' offices, C.P.A. firms, and college professors, and see if they are worth what they are being paid.

Mr. SCHEEL. Except we can see here, where antirebate statutes prevent, uniquely prevent that person from meeting that moral commitment.

Mr. MARRIOTT. I think there are two different issues here. One issue is, should an insurance agent be allowed to give back his commission if he wants to; that is the issue I think we are addressing here.

But I have gotten here from this testimony that you are against insurance agents in general and think that the commission schedules are too high, in particular. Therefore, your issue appears to me to be more of a moral issue because commissions are so high, we ought to allow agents to give it back.

Mr. SCHEEL. If that is the impression I left you with, let me correct it.

No; it is not my judgment to pass any kind of moral commitment on the marketplace nor indeed how the market runs. Rather, it is my role to question whether insurance commissioners have maintained their legal responsibiity of monitoring competition and assuring competition.

Here we have an example of insurance commissioners passing laws allowing their continuation when, in fact, they are noncompetitive. That is what we are talking about.

Mr. MARRIOTT. One final question: Do you think insurance commissioners are dominated by national bodies so that they are not able to promote what they would like to promote?

Do you see what I am getting at?

Mr. SCHEEL. You mean are they under the thumb of the industry?

Mr. MARRIOTT. Are they under the thumb of the other commissioners in a way that precludes them from acting independently?

Mr. SCHEEL. I would hope, sir, if they are under the thumb of the industry that the McCarran-Ferguson Act would have been chucked long ago.

Mr. MARRIOTT. Thank you, Mr. Chairman.

Mr. LAFALCE. Thank you very much, Professor Scheel.

At this point I would like to introduce into the record an article in the March 16, 1981, Best's Insurance Management Reports entitled "Proposal To Repeal Anti-Rebate Law Stirs Emotional Outcry in Wisconsin," and I would also like to introduce from the March 1981 Journal of the Society of Chartered Property & Casualty Underwriters an article by Dr. Roger A. Formisano entitled "Property and Liability Insurance Markets in a Net Pricing Framework."

[The articles follow:]

[From Best's Insurance Management Reports, March 16, 1981]

PROPOSAL TO REPEAL ANTIREBATE LAW STIRS EMOTIONAL OUTCRY IN WISCONSIN

(By Doris Fenske)

When it comes to government regulation, members of the insurance industry are as ready as anyone else to complain that there's too much of it. But a proposal by Wisconsin Insurance Commissioner Susan Mitchell to remove some of that "unnecessary regulation" is being met with vociferous arguments for keeping it in place.

The issue that is responsible for the emotional outcry is Ms. Mitchell's proposal to repeal the anti-rebate law that currently prohibits Wisconsin agents from "reducing the amount of commission fixed by the company, or from offering other inducements to prospective buyers." Wisconsin is one of 50 states that have such laws, which, in the commissioner's view, prevent agents who may be able to market insurance "more efficiently" from passing on savings to their customers through a voluntary reduction of the commission rate. Ms. Mitchell's proposal, one of five bills recently introduced in the Wisconsin State Senate in an effort to eliminate unneeded regulation, would remove that restriction, spurring price competition, she believes, and "opening the door to alternative and perhaps less costly forms of marketing."

Although repeal of the law would affect both life/health and property/casualty lines, its greatest effect undoubtedly would be felt by life insurance agents, who are mobilizing under the banner of the 3000-member-strong Wisconsin Association of Life Underwriters to oppose enactment of the proposal. But the life agents, who charge that repeal of the law would harm the consumer and destroy professionalism in the industry, are drawing considerable support from major property/casualty associations like the Professional Insurance Agents of Wisconsin and the Independent Insurance Agents of Wisconsin. Even the Wisconsin Insurance Alliance, which represents 43 property/casualty insurers in the state, has made its objections known, siding with agent groups which contend that the controversial bill requires more study. The mounting opposition promises a lively debate when hearings on the bill begin in April or May.

Commissioner Mitchell is gearing up for what she admits will be an uphill battle, and has attracted some support of her own. Groups favoring her proposal include the National Automobile Association of America, the Wisconsin Consumers League and the National Insurance Consumers Organization. NICO's support, however, is conditioned on the imposition of a 55 percent maximum on first-year commissions for life agents similar to that in effect in New York, and idea that Ms. Mitchell finds distasteful. "I'm not fond of that approach," she admitted. "It goes against my grain of letting the marketplace work." The embattled commissioner, who says she studied the pros and cons of the issue for a full year before coming out for repeal, also has appeared before the editorial boards of various Wisconsin newspapers to seek backing for her proposal.

"Life company officials agree that the market is not competitive for the buyer," Ms. Mitchell told Best's. Companies compete for agents, not buyers, on the basis of the size of commissions, which can be s high as 120 percent of the first year's premium, and the too-frequent result is that the agent places a policy because of the commission it brings, not because it is best for the client.

Pointing to the deregulation of stock brokers' commissions in 1975, the commissioner suggested that repeal of the anti-rebate law would encourage the development of alternative marketing strategies such as charging a fee for services instead of a commission. Isolating the cost of the "pure insurance product" minus the commission would make it easier for consumers to make apples-to-apples comparisons of the costs of policies, she believes, and would remove the disincentive in the current system that attracts agents to a higher-priced policy because of the commission. "Only the inefficient producer is harmed by removing the law," Ms. Mitchell declared, "and it's not my role as a commissioner to protect inefficiency."

Ray Martin, executive vice president of the WALU, views the proposal in a quite different light. "It would destroy the professionalism in the field," he asserted. "There are too many people looking for a fast buck. It would put the thieves on the street." Mr. Martin noted that the anti-rebate laws were enacted following the lengthy Armstrong investigations of 1906 that examined unethical practices then prevalent in the life industry. "Armstrong said that rebating is like sin and should be regulated against," he said. Removing the law, in his view, would encourage the proliferation of secret deals and payola. If the proposal passes, he warned, "there are many people who would have no scruples about taking advantage of the consumer. It would become a ruthless business."

Mr. Martin also raised the argument that the anti-rebate law is an anti-discrimination measure which prevents certain consumers from having an unfair advantage over others. "If you allowed rebating, the sophisticated person would know how to negotiate: the average person would not," he maintained. Moreover, he said, it would lead to "mass replacement" by encourageing people to transfer policies from year to year simply to obtain another rebate. Consumers would base their insurance decisions on the size of the rebate, not on the merits of the policy, and the cost to consumers would actually be increased because agents would demand higher commissions so they could give more back. "This has to come from a person who doesn't

understand the industry," Mr. Martin said of Ms. Mitchell's proposal. "If the law is on the books in 50 states, it's a good law."

The life agents also cling to the dictum that life insurance is sold, not bought, and point out that the consumer is entitled to lifetime service on his policy. Permitting rebates and other inducements like free toasters and other gifts would attract unscrupulous agents who would sell policies quickly and not stay around for the service needed later on, they say. The anit-rebate law protects the consumer by preventing agents from "dangling carrots in front of the consumer's eye," Mr. Martin emphasized. "Nothing should be allowed that would bait the consumer."

All of these objections to repeal are familiar to Ms. Mitchell, who said, "I haven't heard any arguments that persuade me it wouldn't work." On the question of maintaining the professionalism of the industry, he points to the fears expressed by stock brokers when brokerage commissions, previously set at a fixed rate, were made competitive in 1975. Following the deregulation, many "no frills" discount brokerage houses sprang up that offered investors reductions of 50 percent or more in commission rates. But the full-service houses continued to flourish, and even today the discounters take up only a small share of the business (about 8 percent, according to a January 11 story in the New York Times).

Unfortunately, Ms. Mitchell said, few people in the insurance industry seem to be able to draw parallels with developments in other professions. "The industry talks to itself constantly," she said, and this has led to a kind of "tunnel vision."

Opponents of the bill, she said, "continue to talk about rebates as if that is the only issue, when what we're really talking about is reducing the price." There are abuses in the industry now and there always have been, she pointed out, but repeal of the law will not exacerbate those abuses or promote corruption. Moreover, she emphasized, the anti-rebate law essentially is unenforceable and, in fact, is not being enforced vigorously. "If you interpreted the law literally, agents could not even give out free calendars, because it would be considered an unfair inducement," she noted. "Everybody knows there are rebates now. Technically, the law is being violate every day."

Ms. Mitchell also challenged Mr. Martin's assertion that repeal of the law would promote discrimination. "Our anti-discrimination law would stay on the books," she stressed. "Mr. Jones and Mr. Smith would get the same rebate. Sears Roebuck doesn't charge one customer less than another." The Armstrong investigations, she added, came about because of a total lack of regulation and the misrepresentation of policies that was rampant at that time. Today, there are sufficient controls regarding things like dividends and cash values so that rebates could be permitted, she suggested.

Repeal of the anti-rebate law would not encourage the replacemet of policies, in Ms. Mitchell's view. On the contrary, she said, it is precisely the current system that invites improper replacement because of the incentive to obtain the high first-year commission. And changing the law "doesn't automatically mean less service" for policyholders, she insisted. With the current rate of turnover for life agents, servicing of the policyholders is a problem even today.

Property/casualty agents in Wisconsin share many of the same fears of the life agents and add a few arguments of their own. "We're foresquare against it," declared Stony Steinback, executive secretary of the PIA of Wisconsin. "It would nurture graft. That's what it smacks of—it smacks of something shady. She's hoping that agents will get into an unholy price war and write policies at next to nothing."

Mr. Steinbach maintained that repeal of the law would create havoc with company accounting systems. In estate cases, for example, unethical agents could say they had given up all commissions on policies they had sold, and this would affect the unearned premium value credited to the estate, which in the case of a large policyholder could amount to thousands of dollars.

Another drawback he sees is that in cases where policyholders are locked into a particular company because of adverse loss experience, an agent could take advantage of the situation by charging those policyholders more. Agents could start charging fees for filling out forms and other services, he added, and the small agent would be squeezed out because he could not match the rates of his larger competitors.

"The rebating law as it now stands in all 50 states was established for a sound reason," Mr. Steinbach said. "That reason still exists today. Insurance is an intangible which must have some regulation to work. Unregulated competition will destroy it and ruin an established economic mechanism which has benefited the Wisconsin economy as a whole."

Similar objections were voiced by Robert Jartz, executive assistant of the Independent Insurance Agents of Wisconsin. Repeal of the law, he said, "would give impetus to unsavory elements and invite crime and chicanery into the industry. We

feel the consumer is best served by the present law. It was set up to make sure you don't have any hucksters or fast-buck artists."

The people who would be hurt the most by repeal, Mr. Jartz said, are the small-time agents. A large company could target the market in the state, come in and give rebates, then raise prices the following year once the competition had been destroyed. Or the underworld could come in and then skip the state after the policies were sold. "Repealing the law would make the rich richer and drive the little guy out of business" Mr. Jartz declared.

And at least some of the property/casualty agents' objections are based on sympathy towards their colleagues in the life/health field. "The attrition rate for life agents is nine out of 10 the first year," Mr. Jartz noted. "It's tough enough already without worrying about giving toasters away."

Would smaller agents suffer as a result of repeal? In Commissioner Mitchell's view, it would have the effect of making the industry "like any other market place," with people choosing where they want to shop. She conceded, however, that "to the extent that there are some inefficient agents, some of them could go out of business." She is not concerned about problems with accounting systems because a company could make changes in its system if necessary and, in any case, the proposal would not "force the system to change—it only allows it to."

The opposition expressed by the property/casualty agents, Mr. Mitchell suggested, is an example of the industry's refusal to break ranks, because the fact of the matter is that property/casualty agents would not be affected greatly by the proposal. These agents already negotiate commissions on commercial accounts, "so in the commercial lines it's happening already," she said. And the property/casualty agents who have approached her on the subject have indicated that they rarely can reduce commissions on individual accounts.

Even in the face of the staunch opposition to the bill, there is some indication that a compromise is not completely outside the realm of possibility. Paul Mast, executive vice president of the IIA of Wisconsin, reported that his organization's legislative committee had met with Ms. Mitchell to propose modifications of the proposal. "We're working up some language to suggest that any inducements offered by the agent would have to be offered by the company. It would have to be part of the contract or the endorsement," Mr. Mast explained, suggesting that this would make the transaction aboveboard and prevent any under-the-table dealings.

Mr. Mast reiterated the IIA's strong opposition to the commissioner's proposal but had some words of praise for her overall goals. "Her objectives are sound—she is trying to deregulate," he said. "We're sympathetic to her objectives: we're not sympathetic to this bill."

Although it is too early to tell whether any compromise can be reached, there is little doubt that the upcoming debate in Wisconsin will focus national attention on the rebate issue and ensure the thorough discussion that Commissioner Mitchell has been seeking.

[From the CPCU Journal, Vol 34, March 1981.]

Property and Liability Insurance Markets in a "Net Pricing" Framework

(By Roger A. Formisano, Ph. D.)

(Abstract: This paper continues the discussion on agent compensation and price competition in property/liability insurance. "Net Pricing" is suggested as an alternative to the present fixed commission schedules.)

LITERATURE AND ISSUES REVIEW

In 1973, Joskow [16] concluded that property and liability insurance markets were characterized by excess capacity, unnecessarily high prices, and a grossly inefficient sales method, referring to the American Agency System. In the same year, a study, entitled the "Florida Manifesto" [9], conducted for the Florida Association of Insurance Agents concluded that agency work forces were operating at 25–35 percent efficiency and prices for agency products were not at competitive levels. While these analyses came to seemingly similar conclusions concerning operating characteristics of property and liability insurance markets, the solutions proposed by each were drastically different.

Joskow emphasized deregulation of insurer prices, increased availability of consumer price information, and also suggested reforms which would speed the transition from agency production to direct writing. Among these latter suggested reforms

were: eliminating laws which acknowledged agent ownership of renewals or which prohibited companies from the direct writing of existing policyholders, enjoining trade associations from actions in concert against companies moving to the direct writing technique, and, in general phasing out the American Agency System.

The Florida Manifesto "also recognized inefficiency and price problems in the marketing of property and liability insurance policies, but did not suggest that the American Agency System approach was inappropriate, undesirable, or necessarily the sole cause of the market problems that agents faced. Indeed, that report suggested reforms primarily within the agency-insurer dyad. Of primary importance were the following suggestions: universal acceptance of the direct billing system, increased visability via advertising, and improved personnel training and supervision so that division of labor skills (sales-agency management) could be utilized with maximum efficiency. The study did not recommend any reduction in agency commissions.

The conclusions and solutions proposed by these publications have spawned a number of other projects which have investigated further the level of price competition, marketing approaches, and economic conditions in property/liability insurance markets. In particular. Etger [6, 7] investigated service and cost differences between direct writers and independent agencies. Cummins [3, 4] observed, in a detailed fashion, the operation of agencies and specifically addressed the issue of economies of scale in agencies. Ippolito [14] and Hiebert [11, 12] examined relationships between different regulatory approaches and price levels.

In general the body of empirical research has found that the conditions observed by Joskow and the Manifesto have continued throughout the decade. In particular, academic research has supported the notion that effective price competition should be fostered in the property and liability insurance markets. This price competition would force producers and companies to become more efficient, excess capacity would thus be either utilized or eliminated, and in turn, price levels and price dispersion to consumers would be reduced.

Recently, Lilly [19] focused attention upon market conditions and consumer behavior which support changing the system of agent compensation within the American Agency System. Lilly argued that persistent inflation has led to increased consumer premium awareness and a concurrent attack upon the existing percentage commission schedule. Further, this research reports that traditional service differentiation between direct writers and independent agents may not be as meaningful to cost-conscious consumers as it once was. Lilly concluded by suggesting an alternative to the existing commission system which is based upon a graded (but fixed) fee and premium approach.

Noha [23], in a recent address, also recognized the market share decline of the agency companies but reaffirmed support for the independent agent concept. Suggested as reforms are stronger, less adversary, relationships between companies and agents. Specifically cited are commission and cancellation guarantees for agents in return for consistency in policy placement by agents. Company writing stability and price stability, in the personal lines business, are also recommended.

In sum, a significant amount of empirical research of the property/liability market has been conducted. The facts indicate that some changes appear to be justified to reduce excess capacity and increase price competition. Further, the market share slide of the American Agency System companies has, for the most part, continued uninterrupted over the recent past. In response to these observations, current insurance research has turned to proposing and evaluating systematic changes in the property/liability insurance industry and its channels of distribution. This paper examines the "net pricing" of insurance contracts as a vehicle for improving competition, pricing, and the viability of the American Agency System.

THE "NET PRICING" APPROACH

Current Insurance Marketing Practices

Under the present system of marketing property and liability insurance policies, insurance companies determine the retail price of the contract. Sales agents are compensated with a percentage commission of the premium paid by the consumer.[1] The amount of the commission percentage is negotiated between the agent and the company, but once determined, it is fixed by agency contract. Generally, each company has uniform commission rates across agents for pricing convenience.

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[1] Refers generally to American Agency System agents. Other agents may, in fact, be employees or be compensated at least in part with a salary.

In this sales environment, two agents selling a policy from the same insurance company would usually require the same premium from a particular insured and each agent would earn the same sales commission. Moreover, even if one of the competing agents were willing to accept a smaller commission and accordingly reduce the buyer's premium, the practice would be illegal under most state insurance codes as a violation of the anti-rebating provision.

The basic change envisioned by the "net pricing" of insurance is that companies would price contracts to the agent, net of commission and agency expenses, and the agent would subsequently price the product to the consumer. This process is more akin to the traditional manufacturer-wholesaler-retailer arrangement than is the existing insurance pricing process. Under the net pricing approach, agents would be free to determine their compensation independently of insurers, based upon costs, or what the market would bear, or as a commission, or as a fee.

The environment in which the present delivery system of insurnace was formulated viewed agent retail-price-setting as improper. In Mehr and Cammack [22], for example, anti-rebating laws are characterized as designed to maintain fair competition among agents, to protect career agents from avocational ones, and to protect the public interest by preventing the larger agencies from driving smaller ones from the market and thus reducing competition.

The legal basis, however, of anti-rebating laws is a consumer protection framework. Kimball and Jackson [18] categorize rebating practices as discriminatory acts which are injurious to policyholders. Discrimination is defined as any practice which gives some policyholders an unjustified advantage over others. The argument regarding rebates holds that any inducement to insure which is not in the policy and hence not made available to all policyholders is illegally discriminatory.

Historically, during the late nineteenth and early twentieth centuries, commission rates rose quite dramatically as insurance companies attempted to attract the best agents. As the agents received more compensation, without a corresponding increase in cost or service, the practice of rebating to "buy the sale" became more common. Thus, as some agents received uneconomical commission amounts from their companies, some policyholders were lured to those agents and products by the inducement of a rebate. In response, the practice of rebating was forbidden as an unfair attack upon the "proper" commission level.

In practice, anti-rebating laws are not and probably cannot be enforced with vigor. Furthermore, the lack of enforcement capability of the anti-rebating laws may promote an unfair advantage—and to the least deserving consumers and agents. While Kimball and Jackson [18] propose statutory changes which might remedy the unenforceability of anti-rebate laws, they more pointedly challenge the desirability of the laws. Further, they note (in 1961) that although an initial purpose of the regulation was the preservation of the agency system via maintenance of the compensation level, the effect of anti-rebate laws may be "to undermine that system and substitute direct selling methods."

Justifying the Investigation of "Net Pricing"

The existence (and success) of the direct writers is evidence that current market conditions differ markedly from those that existed when anti-rebate laws were initially justified. Growth in market share for these companies reflects a significant consumer interest in price differences among companies. More importantly, the empirical evidence cited earlier which indicates excess capacity, high prices, and inefficiency in the marketplace, supports the argument that agents' compensation levels may require less protection than originally believed.

Another important factor in justifying an examination of net pricing is the regulatory trend in non-insurance markets away from legalized price supports for retail goods and services. Repeal of Fair Trade Laws via federal legislation in 1975, prohibited manufacturers, for example, from fixing retail prices. Under the present insurance pricing system, the insurer directly fixes the retail premium and the seller is prohibited from changing that price by the anti-rebate laws and/or by the agency contract with the insurance company. Thus, the "net pricing" proposal can be viewed as an extension of repeal of Fair Trade Laws applying to the insurance business.

The "net pricing" proposal can also be viewed as elimination of a fixed commission schedule. Historically, service-type products have compensated sales-people through commission systems. In many of these businesses the commission levels have been fixed either by contract or industry agreement. Recently a number of regulatory authorities have moved to eliminate these fixed commissions and have the sales of service-type products subject to price competition.

As and example of the trend to non-fixed compensation, in 1975 the Securities and Exchange Commission abolished fixed rates of commissions associated with securi-

ties transactions. In real estate sales, both state courts and some state government bodies have encouraged differential commission structures among brokers. Most recently, the Civil Aeronautics Board recommended that the airlines industry should not fix travel agent commissions, but rather each carrier independently should determine a commission schedule for sales remuneration. The net pricing proposal in insurance markets is then a continuation of the trend to market-based compensation that has been in evidence in other service industries.

In sum, the preceding evidence indicates that personal lines property and liability insurance markets have been characterized by inefficiencies which are reflected in higher prices, excess capacity, and growth of the direct writers. The theoretical prescription for these symptoms is the encouragement of effective price competition. This paper recognized the argument for permitting insurance agents to determine the retail prices of insurance policies. This change can be legally implemented easily by (1) repeal of anti-rebating statutes, and, if necessary, (2) state legislation prohibiting insurer retail-price or agent-compensation fixing. This proposal is also consistent with the trend toward competitively based rates of commission in other service industries and the repeal of Fair Trade Laws.

Discussion

A fundamental underpinning of the "net pricing" approach is that agents, rather than insurers, are in the best position to measure agency costs and therefore price agency services. Given this premise, agents should be free to determine the retail price of insurance contracts that they sell. Agents would forward the "net price" to the insurers as is the current practice, but insurers would not be permitted to dictate the retail price that the consumer would pay.

This pricing framework is appealing in a number of ways. First, the approach is philosophically attractive since retail prices would be determined closer to the marketplace and would more directly reflect the product and service costs involved. Geographical input price differentials (labor, rents, etc.) could be reflected in prices rather than averaged according to the territorial range of the company or national average. Furthermore, the labor supply (number of agencies in a locale) would affect prices in the manner envisioned by the free enterprise economic model. Communities with a few agency outlets may compensate the suppliers of insurance policies more generously than those with many agencies. However, the additional compensation (excess profits) would be an inducement for others to enter the market. Of course, if a community were subject to excess capacity, some agencies might be eliminated as the most efficient agents could sell identical products for lower prices.

The "net pricing" approach is also appealing given the operation of the American Agency System. Independent agents represent many companies. When an application for insurance is taken, the agent can usually place the business with one of a number of companies. Cummins and Wiesbart [4] report that company choice, when made by the agent for the new client, is frequently (47.9 percent [2] made on the basis of the company paying the largest commission. Under "net pricing," agent choice of company for this group is likely to be made on the basis of the company with the lowest "net price," since the agent will have the greatest negotiating flexibility and greatest earnings potential with the lowest net cost product. The impact of substantial agent choice based upon lowest "net price" is that agency *companies* would have to compete for agent placements based upon "net prices." Again, excess insurer capacity cited by previous researchers might be reduced as the most efficient insurance companies would attract increasing market shares.

Finally, the "net pricing" approach is appealing because it would introduce an aspect of price competition that is generally not present in the current system. Under the "net pricing" framework independent agencies would become direct competitors with one another. Whereas in the present mode two agencies soliciting the same customer with a policy from the same insurance company could not price differentiate, in the "net pricing" mode, the annual premium could be negotiable. Here again agency efficiency in services offered would become significant in determining flexibility.

A recent study by Skinner, Childers, and Jones [24] suggests that property and liability insurance consumers are generally price sensitive. In particular, they found that 25 percent of automobile insurance buyers and 35 percent of homeowners insureds would switch insurance companies (or agents) for a price differential of under $30 in an annual premium. This consumer receptivity to modest price reduc-

[2] This percentage represents the proportion of agents choosing the response as the highest rank. An additional 17.2 percent of agent respondents reported that the lowest priced product is chosen under current marketing practices.

tions indicates that the "net pricing" approach could lead to significant market share shifts which make possible "low markup, high volume" agency strategies.

There are also possible negative consequences of a change to the "net pricing" approach. Although the legal implementation of "net pricing" is relatively easy, the operational implementation of the approach will probably be more difficult for agencies, companies, and agency-company interfaces. Clearly, the centralization by insurers of direct billing systems would require modification if each agency were permitted to vary the retail price to each client. Also the strength and unity of independent agents associations may be challenged as each agent and agency would have to decide on a pricing and service strategy. Some may choose the "no frills" or discount market, while others could select the highly bundled services approach. Local agency advertising and marketing decisions would take on significantly greater importance, which may overshadow any consumer gains in agency operating efficiencies created in other areas. The ultimate impact that these kinds of changes would have upon the price and availability of insurance products requires further empirical research.

SOME NON-INSURANCE ANALOGIES

During the most recent decade, a number of market and marketing changes have occurred in non-insurance areas which are analogous to the proposed change to "net pricing." It is instructive to examine the experience of these situations to aid in predicting the impact of "net pricing" in property/liability insurance markets. Two examples are particularly relevant: (1) the repeal of Fair Trade Laws, and (2) abolition of fixed commissions in securities markets.

Fair Trade Repeal

The concept of fair trade is that the product owner (manufacturer or wholesaler) establishes a minimum price below which the product may not be sold. In this price control system, retailers are forced (by contract and state/federal law) to sell these branded, fair trade products at or above these minimum prices. The percentage of retail trade that was subject to fair trade was fairly low, estimated at about 10 percent. Goods typically associated with fair trading were: drugs, cosmetics, books, cameras, appliances, and sporting goods. Although the fair trade practice began as a manufacturers tool of price control and maintenance, retail merchants supported fair trade practices strongly.

In December, 1975, the Consumer Goods Pricing Act was passed by Congress and signed by President Ford. This legislation formally ended interstate price maintenance in the United States. Johnson and Boone [15] suggested that prices would drop immediately, then slowly increase, stabilizing at a level below the former fair trade price. The demise of fair trade laws also concerned some observers who believed that small retailers could not survive without price maintenance. Johnson and Boone replied that in the District of Columbia fair trade laws never existed and small drug, liquor and applicance dealers existed side-by-side with giant discount stores.

Hourihan and Markham [13] empirically observed the effects of fair trade repeal in Rhode Island using a case study approach. In general, this research shows mixed results in the marketplace. The authors concluded that prices did not universally collapse following fair trade repeal, nor were product availability or sales volume affected materially. Hourihan and Markham did observe a realtionship between lower retail prices and reduced availability to consumers.

The analogy between repeal of fair trade laws and the repeal of anti-rebating laws for insurance agents goes beyond the legislative similarity. Under the current system of insurance marketing, independent agencies are given a retail price at which the insurance policy must be sold. In this case the agent, acting as the retailer, is prevented from discounting the insurance product just as the appliance dealer was, under fair trade, prohibited from disconting a Sony television set. The experience since repeal of fair trade laws has not been completely examined and is generally mixed. There appears to be, however, incresed consumer availability of discount merchants, with little emphasis on service, while small retailers have survived, typically with an emphasis on personalized service. Importantly, the buyer is given the choice.

Commission Deregulation in the Securities Markets

An analogy can also be drawn between the abolition of fixed commissions for securities dealers and the "net pricing" proposal. Many observers believe that the nature and demographics of the securities dealers environment is close to the environment of the American Agency System enterprise.

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On May 1, 1975, The Securities Acts Amendments of 1975 were passed and became effective. Under that legislation, brokerage commissions were made competitive, rather than fixed, and according to Stoll [25], ". . . the introduction of competitive rates saved consumers . . . millions of dollars without causing the harmful and disruptive effects anticipated by opponents of competitive rates." Among the arguments against the change were that competitive rates would lead to (1) "destructive" competition, (2) higher trading costs for small investors, (3) a reduction of research, and (4) difficulty in maintaining the solvency of brokers.

Regarding the reduction of commissions, Stoll reports that for the small investor, average commissions have not been reduced. Importantly, however, the opprotunity to choose a lower (or unbundled) level of services with a corresponding lower commission has been made available. This alternative has spawned a number of discount practices among the brokerage houses.

Stoll also reports that since the abolition of fixed commissions, brokerage profits have been reduced. That research concludes, however, that brokers continue to earn at least a normal return and the profit loss is associated with monopoly profits which existed with fixed commission levels. Further, concentration in the securities industry has increased and the number of firms has decreased. Neither of these results can be totally ascribed to the introduction of competitive rates, however. In fact, Stoll can cite no evidence that small or regional firms were adversely affected by the change.

In sum, the experience of securities dealers and fair trade product retailers indicates that although market changes occur, the "destructive competition" and "demise of the small merchant" arguments do not hold. Indeed, the consumer appears to benefit from broadened use of different marketing and pricing strategies.

These results have not gone unnoticed by regulatory authorities. Recently, the Civil Aeronautics Board (CAB) has challenged fixed commissions in travel agency relationships with airlines (Business Week, April 28, 1980). Real estate agencies have also begun to chip away at cartel-like commissions in property sales. Some flat-fee and negotiated real estate commission companies have been successful in penetrating the real estate sales markets. It is natural to wonder, given these developments, how long independent insurance agencies can remain steadfast in maintaining a fixed commission compensation system.

SUMMARY

This paper attempts to continue the discussion of independent agency compensation by outlining the history of anti-rebate laws and by developing the argument for their repeal. Others have mentioned the "net pricing" approach but have not fully developed the justification or substance of the proposal. This paper, it is hoped, will spur the discussion of agency compensation and will spawn the further research that is necessary to fully understand the impact that "net pricing" would have in property/libailbity insurance markets.

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Mr. LAFALCE. I would now like to call to the stand representatives from the National Association of Life Underwriters, particularly Mr. William Albus, their associate general counsel; Mr. Julius Vogel, the senior vice president and chief actuary of the Prudential Insurance Co., speaking on behalf of the American Council of Life Insurance; and Mr. E. Stony Steinbach, executive secretary of the Professional Insurance Agents of Wisconsin, speaking on behalf of the National Association of Professional Insurance Agents.

I would also like to have other insurance agencies go on the record either in favor or against commissions based on deregulated commissions.

We would be delighted to include their comments in the record. We will continue to solicit opinions from them and from other trade associations other than insurance associations.

Also for the record I did ask the independent insurance agents to come today but they have a convention outside of the Washington, D.C. area, which precludes their attendance.

Now, let me call upon Mr. Albus.

TESTIMONY OF WILLIAM N. ALBUS, ASSOCIATE GENERAL COUNSEL, NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

Mr. ALBUS. Thank you, Mr. Chairman.

Mr. LAFALCE. We will include the entire text of your comments in the record, so if it is your desire, you may read them in toto or summarize them.

Mr. ALBUS. I was going to ask for that, Mr. Chairman. I have severely edited my remarks.

By way of introduction and understanding, the National Association of Life Underwiters is a federation of local and State associations.

There are about 1,000 of them.

The individual members, life and health insurance agents, are members of the local associations. There are approximately about 134,000 of those.

If any individual group can be characterized as small businessmen, it is this one.

I noticed Professor Scheel classified small businesses at 50 employees. Most of our local association members do not even have one, so they are truly small businessmen.

Please do not tell them there is no competition. You can pick up any newspaper, mostly on Sundays, but at any time and you can read where no agent will call, no agent's commission will be paid.

You probably would be hard pressed to find an employer that does not provide group life insurance for his employees, sometimes sharing the cost, sometimes free.

Indeed, almost every association you join today provides insurance coverage regardless of the intent of the association or its reason for being formed.

Of course, the Government itself provides insurance programs for servicemen and veterans. There are other consumer choices as well insofar as our members are concerned. Naturally, prospective purchasers can always go to another company or shop around for the cheapest coverage.

Most importantly, the consumers—and perhaps this is the main competitive disadvantage for our members—can go without any life insurance coverage.

People cannot do without drugs, houses, cars. Life insurance they can.

On the face of it, rebating appears simply to involve one individual giving to another part of what he has legitimately earned, a voluntary sharing of the wealth.

The actual consequences though I think, as we will learn when we examine the issue, are considerably more serious.

The sale of insurance has always been a somewhat difficult task as opposed to the sale of tangible goods. In this regard, I might digress just a moment.

I have heard a lot of talk today comparing agents with retailers. They are not retailers. They do not buy insurance policies in bulk and resell them. They do not even accept them on consignment and resell them.

Because of its amorphous nature, that is, a promise given in the insurance contract, a buyer is less likely to understand what it is he's purchasing.

In few, if any, instances do purchasers contact agents and demand coverage for life insurance. Indeed, our members discovered quite early in their careers that many individuals are reluctant to discuss either the idea of dying or the possibility of providing for contingencies after they have gone.

The purpose of life coverage is an obligation rather than a pleasure and even when done willingly does not result in the same gratification as is often achieved in consuming material goods.

Because of these unique chacteristics of the product, the sale of life insurance can readily lend itself to the employment of methods which involve extra-contractual promises of money or property in order to induce a prospect to purchase coverage.

As noted previously by other witnesses, the question of rebating is not new.

The Armstrong committee, in its final report, asserted that the illegal and wasteful practice of rebating had its source in undue competition and thrived upon excessive commissions allowed agents.

In 1904 a spokesman for the National Association of Insurance Commissioners observed:

> Rebating cheapens the public estimation of insurance indemnity. It educates the insurance class to the idea of "kiting," it demoralizes the agency field and renders precarious in its financial returns the honorable advocation of insurance soliciting.

At the outset, I would like to clarify one possible misconception regarding this subject.

I have noticed that, in discussions on life insurance rebating, antagonists frequently equate life insurance coverages with other goods such as cars, refrigerators or stocks and bonds and the services of life insurance agents with the services of other professionals such as lawyers, stockbrokers, and realtors.

However, there are severe differences regarding product and marketing philosophies.

An additional distinction exists between life agents and other professionals regarding compensation. The former's commission is based directly on the product.

Due to the nature of the product and its long-term commitment, costs must be calculated when insurance premiums and/or dividend scales are established.

I might note another distinction between agents and other small businessmen these days. With inflation the latter are able to pass their increased costs on in increased product prices.

However, insurance agents, with the product price going down and the increased costs of doing business going up, can not do this; yet this measure H.R. 4497 is intended to force him to negotiate even this diminishing income.

Since the compensation formula for the life underwriters is not the same as for other professionals, but is an integral part of the premium, and inasmuch as premium rates are set by the company, it is within the province of the company to determine what, if any, rebate is desirable.

To suggest that agents' commissions, a minor part of the total price of the product, be the only portion of the premium subject to negotiation seems unduly harsh.

In considering the correct course of action regarding insurance rebates, it serves no useful purpose to blithely ignore this difference or blissfully pretend that the compensatory position of life agents is the same as, or similar to, other professionals.

I do not consider this measure necessarily as one of deregulation. In effect, I look upon it as regulation. It would tell the States they are prohibited from enacting antirebating statutes.

In addition to this dictate to the States, such legislation would also effect replacement as has been mentioned, the unfair trade practice requirements, prohibitions against free insurance, and particularly the sharing of commissions with unlicensed persons which each State now prohibits.

It would also feel—although there has been some discussion today to the contrary—have an adverse effect on cost comparisons since nobody woud know exactly the cost of their policy.

We feel it would encourage agent turnover, which is of particular concern to us because, although maybe Mr. Marriott's comment that 1 out of 10 is competent, we don't know any figures on that, but we do know we are striving as an association to increase the competency of agents by continuing education requirements as well as in the initial examinations for licenses.

The replacement regulations, the prohibitions against free insurance, antidiscrimination and unfair trade practice requirements, and the sharing of commissions with unlicensed persons are just some of the areas which require extensive research before this subject can even be intelligently approached.

I am concerned that in prior discussions, many of these other important considerations have not even been broached.

Furthermore, there is the continuing question of whether or not the States should properly be the jurisdictions to take action on this matter.

There is little doubt that the repeal of the prohibition on insurance rebating would have serious consequences affecting commission rates and, ultimately, the cost of insurance for consumers. It certainly will wreak havoc with the attempts of the insurance commissioners and the industry over the past decade to design an effective and accurate method of cost comparison of policies.

Repeal would encourage lapses inasmuch as agents will be able to offer the largest rebates from first-year premiums. Policyholders will be encouraged not to continue their existing policies, but rather to find an agent who will give them bigger discounts from the new first-year commissions.

It almost assuredly would increase agent turnover since well-established agents will be in a superior position to offer better discounts. This development is of particular concern to NALU since the cost of training and qualifying applicants may encourage insurers to cease or lessen agent recruiting.

Furthermore, the assumed consolidation of agencies will not only tend toward monopolization, but will probably produce considerably less service and counseling for consumers.

Most important, however, such an action will produce unfair discrimination among purchasers of life insurance. The antirebate statutes have effectively protected the consumer through an orderly pricing structure. Without such a system, the more sophisticated purchaser, with greater leverage, will reap the more desirable deal.

The smaller buyer will eventually subsidize the bigger. This is one of the inequities which existed at the time the laws were enacted and which they were intended to correct.

There appears to be no distinct advantage in returning to the difficulties which were evidenced during the era antecedent to the rebate proscriptions. There is no clarion call for their removal and consequently the isolated advocacy of such a step must be analyzed carefully, deliberately, and objectively.

The admonition that the time is now to reverse what has proven not only effective but necessary, is hardly sufficient evidence to counterbalance the deleterious ramifications which will be attendant upon an action of this type.

[Mr. Albus' prepared statement follows:]

PREPARED STATEMENT OF WILLIAM N. ALBUS, ASSOCIATE GENERAL COUNSEL, NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

Mr. Chairman and Members of the Committee, my name is William N. Albus. I am the Associate General Counsel for The National Association of Life Underwriters (NALU) which is a federation of nearly 1,000 state and local associations. Membership in the latter totals approximately 140,000 individual life and health insurance agents, general agents, and managers who do business in virtually every community in the United States. NALU appreciates the opportunity to present its views on the proposal to eliminate the statutory restrictions on rebating in the insurance industry.

Quite naturally, life insurance agents have an intense and abiding interest in this subject. On the face of it, rebating appears simply to involve one individual giving to another part of what he has legitimately earned, a voluntary sharing of the wealth, so to speak. The actual consequences, however, can be considerably more serious and comprise a genuine potential danger.

The sale of insurance has always been a somewhat difficult task as opposed to the sale of tangible goods. In the first instance, a purchaser is less likely to understand an amorphous contractual right, indeed a promise, which is contained in the life insurance contract, than he or she would be able to comprehend a physical object. Furthermore, in few, if any, instances do prospective life insurance purchasers contact agents and demand coverages. Indeed, our members discover quite early in their careers that many individuals are reluctant to discuss either the idea of dying or the possibility of providing for contingencies after they've gone. It is much more rewarding for most people to spend money for goods to be enjoyed either immediately or in the foreseeable future. The purchase of life coverages is an obligation rather than a pleasure and even when done willingly, does not result in the same gratification as is often achieved in consuming material items. Indeed, if there has been a change in the public's attitude over the years since the issue of rebating initially arose, it probably is that instant gratification is more in evidence today than it was during the past. Because of these unique circumstances, the sale of life insurance can readily lend itself to the employment of methods which involve extra contractual promises of money or property in order to induce a prospect to purchase coverage.

As noted above, the question of rebating is not new. Perhaps the recent spate of advertising by manufacturers, whereby the term has become almost synonymous with the sale of nearly every tangible product marketed today, has resurrected the question for the insurance industry. In the early 1900's, the Armstrong Committee, which had been appointed by the New York State legislature to examine the practices and affairs of life insurers doing business in that state, considered this very issue along with other legislative proposals to correct the abuses which were alleged to exist in the life insurance industry. The Committee's final report asserted that the illegal and wasteful practice of rebating had its source in undue competition and had thrived upon the excessive commissions and advances allowed to agents.

In addition, a spokesman at the Twenty-fifth Annual Meeting of the National Association of Insurance Commissioners (NAIC) in September 1904, observed, "Rebating cheapens the public estimation of insurance indemnity. It educates the insurance class to the idea of 'kiting,' it demoralizes the agency field and renders precarious in its financial returns the honorable advocation of insurance soliciting." It seems that rebating, ever since it became an issue, has been anathema to insurance marketing.

At the outset, I would like to clarify one possible misconception regarding this subject. I have noticed that, in discussions on life insurance rebating, antagonists

frequently equate life insurance coverages with other goods such as cars, refrigerators or stocks and bonds and the services of life insurance agents with the services of other professionals such as lawyers, stockbrokers and realtors. As noted previously, however, there are severe differences regarding product and marketing philosophies insofar as life insurance is concerned. An additional distinction exists between life agents and other professionals regarding compensation. The former's commission is based directly on the product. Due to the nature of the product and its long-term commitment, costs must be calculated when insurance premiums and/or dividend scales are established. Although they may be revised from time to time, it is obvious that increased commission rates result in increased insurance costs.

Since the compensation formula for the life underwriters is not the same as for other professionals but is an integral part of the premium, and inasmuch as premium rates are set by the company, it is within the province of the company to determine what, if any, rebate is desirable. To suggest that agents' commissions, a minor part of the total price of the product, be the only portion of the premium subject to negotiation seems unduly harsh. In considering the correct course of action regarding insurance rebates, it serves no useful purpose to blithely ignore this difference or blissfully pretend that the compensatory position of life agents is the same as, or similar to, other professionals. There should be no misunderstanding in this regard. Other systems are not the same, and should not be regarded as being the same.

In addition to these dissimilarities in the marketing systems and the uniqueness of the life insurance product, there is every indication that today's consumer climate will produce the same, or perhaps even more egregious consequences, as those which were prevalent when these rebating prohibitions were originally enacted. Certainly, the mere fact that every state has enacted legislation which prohibits rebating in the sale of a life insurance policy would lead a reasonable person to believe that this constitutes a widespread evil which has resulted in this almost unheard of unanimity in state action.

Likewise, the assertion that competition has been severely weakened by restricting rebates appears somewhat to exaggerate the actual facts. There are, few, if any, other products in this country which have decreased in price since World War II. Certainly, the number of new entrants in the life insurance business in recent decades is a strong indication of the competitive state of the industry. Coupled with these factors is the rapid and dramatic product innovation which has taken place over the years. These developments do not appear to be the results of "weakened competition."

I might note, in passing, that if rebating in life insurance is technically "a return of the premium," as it is considered to be, then the practice has been in existence for over 100 years and continues to this day. This definition coincides with that of a life insurance policy dividend.

As indicated above, there are so many considerations involved in this recommendation, time precludes me from adequately examining them in detail. The anticipated effect that a repeal of the antirebating restriction will produce on other laws and regulations is certainly critical and must not be overlooked. The Replacement Regulations, the prohibitions against free insurance, antidiscrimination and unfair trade practice requirements, and the sharing of commissions with unlicensed persons are just some of the areas which require extensive research before this subject can even be intelligently approached. I am concerned that in prior discussions, many of these other important considerations have not even been broached. Furthermore, there is the continuing question of whether or not the states should properly be the jurisdictions to consider action on this matter.

There is little doubt that the repeal of the prohibition on insurance rebating would have serious consequences affecting commission rates and, ultimately, the cost of insurance for consumers. It certainly will wreak havoc with the attempts of the insurance commissioners and the industry over the past decade to design and effective and accurate method of cost comparison of policies.

Repeal would encourage lapses inasmuch as agents will be able to offer the largest reductions on first-year premiums. Policyholders will be encouraged not to continue their existing policies, but rather to find an agent who will give them bigger discounts from the new first-year commissions.

It almost assuredly would increase agent turnover since well-established agents will be in a superior position to offer better discounts. This development is of particular concern to NALU since the cost of training and qualifying applicants may encourage insurers to cease or lessen agent recruiting. Furthermore, the assumed consolidation of agencies will not only tend toward monopolization but will probably produce considerably less service and counselling.

Most important, however, such an action will produce unfair discrimination among purchasers of life insurance. The antirebate statutes have effectively protected the consumer through an orderly pricing structure. Without such a system, the more sophisticated purchaser, with larger leverage, will reap the more desirable deal. The smaller buyer will eventually subsidize the bigger. This is one of the inequities which existed at the time the laws were enacted and which they were intended to correct.

There appears to be no distinct advantage in returning to the difficulties which were evidenced during the era antecedent to the rebate proscriptions. There is no clarion call for their removal and consequently the isolated advocacy of such a step must be analyzed carefully, deliberately and objectively. The admonition that the time is now to reverse what has proven not only effective but necessary, is hardly sufficient evidence to counter-balance the deleterious ramifications which will be attendant upon an action of this type.

Mr. LAFALCE. Mr. Vogel?

TESTIMONY OF JULIUS VOGEL, SENIOR VICE PRESIDENT AND CHIEF ACTUARY, PRUDENTIAL INSURANCE CO., AND ROBERT S. SEILER, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, ALLSTATE LIFE INSURANCE CO., ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE

Mr. VOGEL. Thank you, Mr. Chairman.

I am Julius Vogel, senior vice president and chief actuary of the Prudential Insurance Co. of America. With me is Robert S. Seiler, senior vice president, secretary and general counsel of Allstate Life Insurance Co. We are appearing here today on behalf of the American Council of Life Insurance which represents 525 life insurance companies. These companies account for 95 percent of the life insurance in force in the United States and 97 percent of the assets of all life insurance companies.

We are pleased to have the opportunity to testify concerning H.R. 4497, the proposed Insurance Sales Deregulation Act of 1981.

All 50 States currently have statutes which prohibit rebating by providing that an insurance agent may not offer a special inducement to a prospective customer which is not specified in the insurance policy delivered to the customer. By amendment of the McCarran-Ferguson Act, H.R. 4497 would, if enacted, preempt these State statutes and allow rebating without requiring that the amount or nature of such rebate be specified in the insurance policy. The amendment would clearly contravene the judgment of the State legislatures regulating insurance and ignore the past experience and reasons for the existence of such statutes.

Mr. Chairman, the council and its member companies strongly oppose H.R. 4497 not only because of the specific harm which would be done to the insurance consuming public by its enactment, as I will discuss in a few moments, but for a number of broader considerations which I would like to touch upon now.

Later, Mr. Chairman, I will condense my testimony, but I am reading from my prepared statement right now.

First of all, in your introductory statement for H.R. 4497 in the Congressional Record, Mr. Chairman, you alleged that the insurance business has engaged in massive price fixing of agents' commissions. I would like emphatically to deny that insurance companies have in any way acted in collusion to fix agent commissions. In fact, if such activity had occurred, it would not be protected by

the McCarran Act. We do not have a survey, but I think I can assure you that variances do exist from company to company.

Second, the statement is made in the opening declaration of H.R. 4497 that the current antitrust immunity afforded the insurance industry has severely weakened competition among insurers and had a severe adverse impact on insurance consumers.

We believe that assertion is not supported by the facts. By all of the standard measures of market performance, the life insurance business has demonstrated that it is highly and increasingly competitive. In the 35 years since the enactment of the McCarran Act, the number of life insurance companies has tripled, evidencing low barriers to entry. According to the Justice Department, concentration in the life insurance business is only moderate; it is also decreasing steadily. High figures for life insurance policy ownership demonstrate wide availability of the product. The price of life insurance has declined steadily in the last few years. That is a claim very few other industries can make. Of course, statistical measures are not the only way to gage competitiveness. I can only suggest to anyone who doubts the competitiveness of the life insurance business that they go out and attempt to sell life insurance for a living. It's very competitive.

I am very grateful I can make a living other than by trying to sell life insurance. I have gone out in the field with agents and I know it is a very difficult job.

I would like to make one other point. Just last year, in considering the authorization for the Federal Trade Commission, Congress reaffirmed the basic premise of the McCarran Act that it is in the public interest for the States and not the Federal Government, to continue to regulate the business of insurance.

Mr. Chairman, the issue of insurance commission rebates is obviously not one which has been ignored by the States; it is an area heavily regulated by the States. As is pointed out in section 2(a)(2) of this bill, all 50 States have considered the issue of rebates and have enacted legislation to prohibit the very type of practice which H.R. 4497 would permit. Leaving aside for a moment the question of why every State has prohibited this practice, the point is that the States acted within their legitimate authority in doing so, and it should be their prerogative to determine whether or not antirebate statutes are retained, not the Federal Government's. The council and its member companies continue to support State insurance regulation. We believe in it, and we know that it works and works well. The enactment of H.R. 4497 would not result in improved State regulation as asserted in section 2(b), but would rather be the beginning of an unfortunate, inappropriate, and unwarranted piecemeal approach to insurance regulation at the Federal level.

Turning to the merits of the antirebate laws, it is important to note that they were enacted by the States because of the actual experience of the insurance business between 1885 and 1905, a time when rebating was widespread.

The New York State Senate and Assembly, prompted by improprieties on the part of several companies, appointed a joint committee in 1905 to investigate the practices of life insurance companies in that State. The sweeping investigation, headed by State Senator

William W. Armstrong, produced numerous legislative proposals to correct the abuses. The Armstrong committee thoroughly investigated rebates and concluded that they should be prohibited.

An important outgrowth of the New York investigations was that, in the next 5 to 10 years, most State legislatures incorporated the Armstrong panel's recommendations on rebates into their own insurance regulations. And, in 1946, the National Association of Insurance Commissioners developed its model unfair trade practices act which prohibited rebates. That model has been adopted, with minor variations, in all 50 States. As late as 1972, the NAIC reviewed its position on this matter and reaffirmed its position.

The legislatures of most States have consistently reenacted antirebate statutes, both in recent recodifications of insurance codes and through adoption of the original 1946 and subsequent versions of the NAIC Model Unfair Trade Practices Act. The reviews made by the NAIC and the various State legislatures are impressive reaffirmations of the principles underlying antirebate laws. These statutory prohibitions of rebates have been judicially determined to be reasonable exercises of the police power and therefore constitutional. The basic reasons for prohibiting rebating have withstood the test of time and are still as valid as they were in the late 1800's. Some of these reasons include the following:

One, preemption of the antirebate statutes would cause discrimination among policyholders. Without these statutes, similarly classified policyholders of an insurer with identical coverages would likely be charged varying premiums for the same policies. Premiums paid by such insureds would no longer be determined solely by the characteristics of the risk they present, and the particular policy they purchase, but would instead be subject to the unknown variable of the amount rebated by the agent.

In fact, only the sophisticated purchasers of large amounts of insurance would stand to gain from the practice of rebating. This would be at the expense of the less sophisticated purchasers of smaller amounts of insurance who would not have the economic leverage to demand and receive a rebate from an agent.

In fact, their costs would be driven up in order to subsidize the sales to the larger purchasers.

Such unfair discrimination against the smaller policyholder would surely be an unfortunate result of H.R. 4497, and this is really the most important point that I want to make in this testimony.

The insurance codes and regulations of the various States that have developed over the years contain a number of provisions designed to protect the consumer in the purchase of life insurance, for example, antidiscrimination, replacement, and cost disclosure laws and regulations.

Severing the antirebate statute from this gamut of protections has the effect of frustrating the enforceability and intent of statutes and regulations that are closely related to, if not dependent upon the antirebate statute for their viability.

Two, the effect of permitting rebating would be to increase the cost of insurance. First, commission rates would inevitably increase. To the extent that part of the agent's income is rebated to

their customers, the agents would have to demand increased commission rates from insurance companies.

The average full-time life insurance agent in this country earns less than $20,000 a year. Where will he get the money to rebate except from increased commission rates?

Second and consequently, insurance costs would increase to the general public. This is because all expenses, including commissions, are considered when insurance premiums and/or dividend scales are established and revised from time to time. Just as a reduction in mortality rates ultimately results in reduced insurance costs, so must an increase in commission rates result in increased insurance costs.

I would also point out an agent who feels he can maintain or increase his income by rebating a part of his first-year commission to his client will have considerably less commission to rebate on the second year premium. It is therefore likely that the second year cost to the insured would increase substantially, and there would consequently be a strong tendency for the policy to lapse and be replaced by a new policy with more first-year commission available to rebate. If a policy is lapsed on its first anniversary and a new policy is sold to provide more commission, then the increase in policy lapses will preclude the recovery of acquisition expenses which were originally calculated to be recovered over a longer policy life. This tendency to reduce the average duration that policies remain in force will inevitably result in increased cost to the public.

In considering the impact of the elimination of antirebate laws, it is important to distinguish between life insurance and other consumer products where rebates are permitted. Life insurance is materially different from the products which were formerly subject to fair trade laws, and commissions payable to agents are not comparable to the fixed commissions formerly payable to securities dealers. The fair trade products, such as appliances, are generally purchased and completely paid for simultaneously. Life insurance is the purchase of a benefit to be realized in the future. It requires ongoing payments, and the purchaser has a right to know the amount of these payments at the outset of his purchase.

If rebating is allowed, it will make accurate comparisons between competing policies more difficult for the consumer. The NAIC has developed a model regulation, adopted by the insurance departments of 36 States which affords consumers a cost disclosure and comparison system to help consumers shop intelligently for a life insurance policy.

However, these efforts to help consumers compare life insurance would be frustrated by allowing rebates. It is very likely that the consumer would purchase the policy based on the merits of the initial rebate rather than on the long-term cost and value of the policy and, as a result, purchase the wrong policy.

For the life of me I am not able to understand the testimony that said rebating takes a variable out of the cost comparison process.

It seems me that, on the contrary, rebating adds a variable right in the middle of the comparison process.

The next point I want to make is that if rebating is allowed, it will tend to drive out newer agents, lead to long-term decline in

competition and result in the monopolistic domination of the marketplace by a few very large agencies.

New agents who do not have a large clientele will be less able to compete with established agents who can afford to rebate because they write more business.

I would like to add one more point about this matter of competing at the retail level.

As Mr. Albus says, we don't sell our policies to the agents the way GE might sell refrigerators to department stores, and tell the stores, go ahead and price the refrigerators to the public any way you want.

What we are talking about here is more like if Sears were to start selling its men's suits to its salesmen. Then if a customer goes into Sears and wants a suit, he comes to the first salesman and says how much of your commission will you rebate. If the customer doesn't like the amount of the rebate he can go to the second salesman, and ask him, and so on.

I think that is the kind of thing we are talking about and I think it would be a very disorderly situation.

In conclusion, Mr. Chairman, for the reasons I have outlined, we do not believe that the enactment of H.R. 4497 would in any way benefit the insurance-buying public.

Indeed, we believe it would lead to unfair rate discrimination, diminished competition and higher prices.

We will be happy to answer any questions of the subcommittee and its staff.

Mr. LAFALCE. Now we are going to hear from Mr. Steinbach who is with the National Association of Professional Insurance Agents.

TESTIMONY OF E. STONY STEINBACH, CAE, EXECUTIVE SECRETARY, PROFESSIONAL INSURANCE AGENTS OF WISCONSIN, ON BEHALF OF NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

Mr. STEINBACH. Thank you, Mr. Chairman, members of the subcommittee.

I am Stony Steinbach, CAE, executive secretary of the Professional Insurance Agents of Wisconsin.

We have about 1,200-plus members.

The distinction is they represent property and casualty companies. This is one of the requirements to be a member.

I am appearing also on behalf of the National Association of Professional Insurance Agents, a national trade association of professional independent insurance producers throughout the 50 States, the District of Columbia, Puerto Rico, the Virgin Islands, and Canada.

Mr. Chairman, that is the length of my prepared statement. I will not digress from that at this time.

Mr. LAFALCE. Before you continue, could I ask you to clarify the difference between the National Association of Professional Insurance Agents and the Independent Insurance Agents of America; who their members would be? Would they differ?

Mr. STEINBACH. My members are the professional insurance agents of Wisconsin. As members of the Professional Insurance Agents of Wisconsin, they are a member of the National Profes-

sional Insurance Agents Association. They are coextensive, you might say.

Mr. LAFALCE. I understand that.

What is the difference between the National Association of Professional Insurance Agents and the Independent Insurance Agents of America?

Mr. STEINBACH. Well, that is hard to say without those people saying what their side would say.

Mr. LAFALCE. You tell me what your side would say.

Mr. STEINBACH. In my opinion, we have the same object in mind, the preservation of the independent agent system.

Historically, possibly, we cater to the mutual insurance companies more so than the stock companies.

Mr. LAFALCE. Fine.

Mr. STEINBACH. Thank you.

I do want to focus for a minute on one thing we do agree on, Mr. Chairman. That is what is best for the consumer.

We have no argument on that. That is what we are both looking for.

I appreciate what Mr. Marriott said in regard to the fact insurance is a different breed of cat. I would like to just elaborate on that a bit.

Again I am talking about always property and casualty and there is a big difference there between that and life insurance.

Generally speaking, insurance, property, and casualty is not popular with the people. In essence, there are only two types of policyholders: Those that have losses, and those that don't.

The people that don't have losses feel that they have wasted their money. So when you go back to them and renew and so forth and they haven't had a loss for years and years, they again say well, we wasted our money. They forget the principle of insurance is the many paying for the few.

In regard to that, I agree with Mr. Marriott that it is an altogether different breed of cat. It has been said there is no competition, and nothing could be further from the truth.

I also am an independent agent. I represent some 24 companies, and there isn't a single one in my agency that has the same premium declarations or commission statement. They are all different. They all have a place in the agency because every situation is unique.

Just to show how that can work, I have had a manufacturing risk insured for 30 years, rather hard to place until recently when the market softened.

July 1 it came up for renewal. I shopped the market. Where the renewal was $20,000 with company A, I was able to find a company and place it for $13,000. Sad to say, I lost it to another carrier for $8,000, a competitor. To say there is no competition, nothing could be further from the truth.

Companies are competing and agents are competing, but it is on a uniform basis and I think that is good. To throw commissions into the pot at the last minute is wrong, because it will hurt the little guy.

Mr. LAFALCE. We have waited 81 years. Go ahead.

Mr. STEINBACH. If it is good, or if it is not broke, why fix it?

We, as property and casualty agents don't have much to give up any more.

The commission schedules in property and casualty are really bare bones. We are talking of premiums of $200, for instance.

Let's say the commission is 12.5 percent. What is there left to cut? There is such a thing that the first thing you know you are going to be cutting too much and then will the level of service go down proportionately?

If somebody comes to me and cuts me too much, and then has a lot of losses, I am going to try to recoup it some other way, possibly with service fees.

Then you have him over the barrel. He needs service now. You think about the time he made you work for nothing to get the policy.

You are going to work to make up for it. There is inherent danger there in that.

The statement has been made in some cases for the same amount of work you make *x* amount of dollars. You have to have that.

You have to have gravy to make up for the things that aren't so good. That is in every business.

No contractor could exist if he had nothing but bids that were below. You also have to have bids that are a little higher, where you found the gravy. That is the way it works.

It is pretty hard for the buyer, sophisticated or not, to determine the quality of an agent.

It is impossible to do. If he were to look—and he will. He will look at commission only. He will look at what is he going to knock off the price. I think therein is a problem.

This may be facetious, but assume politicians, in seeking public office, say they are going to return a part of their salary, how do you think the people would vote?

There is another inherent danger. If we can knock off commission, we can probably give the policy away. It wouldn't be long before you would have people giving policies and the unsuspecting would think they have a pretty good policy.

In essence they have something that is probably just a shell.

I have many, many instances. One more in closing: In Wisconsin particularly we have many towns that are small, where years ago there was one full-time agent. You go back to those same towns. Today there are two, three, four full-time agents. Were it that the individual could have rebated, I would venture to say these towns would only still have one agent because the guy that was there, he could have seen to it that the guy starting would not write any new business by just—he is possibly fairly wealthy and he would give away enough of his commission so the new guy couldn't get started.

So in fact it has been good for competition.

I would welcome questions.

As I was sitting here this morning and heard some of those questions, I wish I had a chance to answer some of those. It would be interesting to see what the answers would be from the standpoint of the public.

Thank you, Mr. Chairman.

[Mr. Steinbach's prepared statement follows:]

PREPARED STATEMENT OF E. STONY STEINBACH, CAE, EXECUTIVE SECRETARY, PIA OF WISCONSIN

Mr. Chairman and members of the Subcommittee, I am E. Stony Steinbach, CAE, Executive Secretary of the Professional Insurance Agents (PIA) of Wisconsin, Inc. I am appearing on behalf of the National Association of Professional Insurance Agents (PIA), a national trade association of professional independent insurance producers throughout the fifty States, the District of Columbia, Puerto Rico, the Virgin Islands and Canada.

Comments and sentiments expressed, to date, in the bill itself and ancilliary material contained in the Congressional Record-House, dated September 16, 1981, at pages H6320 and 6321, speak an apparent failure to recognize obvious differences between the various segments of the vast industry. The depth of our membership's expertise lies in the property/casualty segment of our business. Hence, we will focus on applicable dynamics of this sector.

One of the apparent misconceptions surrounds the method by which an agent is compensated. The Congressional Record, cited above, reads, ". . . the insurance statutes in all 50 states require each and every one of those agents to charge precisely the exact same amount of commission as every other agent for that policy." This statement is inaccurate in that agents do not "charge" clients for the service provided. The servicing fee the agent earns is paid to the agent by the insurance company. This servicing fee is a part of the premium charged by the company to the client.

A further apparent misconception which should be clarified is that the remuneration our agents receive is not simply a sales commission. The Chairman and the Subcommittee are certainly sensitive to the fact that the property/casualty agent performs a number of functions, including issuance of certificates of insurance evidencing coverage, change endorsements, claims processing and settlement. Further, it is the professional agent who analyzes his insured's individual insurance needs and searches the marketplace to find the specific insurance coverages at a price acceptable to the insured. The income an agent derives is the quid pro quo for professional services rendered, not a mere sales commission.

This bill alleges that state laws which require an insurer to approve a reduction of servicing fees is anti-competitive and contrary to the interests of consumers. A. M. Best's publication, Best's Aggregates & Averages, reports total casualty property industry premium volume in 1978 of $81.7 billion, $90.1 billion in 1979, and $95.6 billion in 1980. The rate of inflation for 1979 and 1980 years, published by the Bureau of Labor Statistics Consumer Price Index Office, were 13.3 percent and 12.4 percent, respectively, while the increase rate of premium costs were 9 percent and 6 percent respectively.

The point is that while a major percentage of goods and services rose in price at or above the rate of inflation, the cost of the insurance product, in the aggregate, has been far below these levels. This year's experience is proving to be another extremely competitive market. It is anticipated that the percentage of increase will again be at or below the 6 percent of 1980, resulting in numerous individual insureds actually paying less premium than in 1980. New carriers can and have entered the marketplace, while established carriers have expanded and/or withdrawn from specific lines. The same can be said for the growth merger and acquisitions of agencies and brokerage firms. These facts are directly attributable to the effects of the competitive forces at work in the free enterprise system. Thus, the contention that broad immunities given this industry have resulted in a severe weakening of competition is not supported by recorded behavior. The competitive forces in this industry are so strong that I know of not a single case wherein an insurance company declined an agent's request to reduce the servicing fee and pass the savings along to the consumer. As a matter of fact, this practice is relatively common. My experience, and that of our membership, indicates that agents received less than the contracted for servicing fee on perhaps 20 percent of their premium volume. Claims that the insurance industry is not competitive, in the abstract or in relation to any other industry, is lacking in foundation.

The bill further maintains that its passage will secure substantial improvement in the State regulation of insurance; however, it has not been demonstrated that State regulation has been derelict on this issue. That statutes addressing this issue exists in all 50 states, have been reaffirmed in numerous recodifications, and incorporated in the NAIC Model Unfair Trade Practices Act, reflects a conscious recognition of the issue and affirmative and responsible action on the part of 50 state legislatures to protect what they view to be in the best interests of their constitutents.

Fair and equitable competitive pricing of insurance is the aggregate of an equation, a singular component of which is anti-rebate laws. The equation of each state adopts to achieve fair and equitable competitive pricing must place all the components in relative balance. The legislatures of the 50 states, having duly considered the issue and the myriad of related issues, have each, independent of one another, arrived at the same conclusion with respect to this single issue. Allow me to re-emphasize, however, that the state legislative action on this particular issue must be viewed in the context of the entire regulatory mechanism employed by the state. Any attempt to modify a single element, without concomitantly adjusting the other variables of the equation, may lead to chaos in the marketplace. Additionally, such action constitutes unwarranted federal meddling in states' rights to self-determination and, on its face, directly conflicts with the intent of the McCarran-Ferguson Act. The states have taken a responsible legislative/regulatory approach, incorporating a studied understanding of the needs of their constitutents, balanced with a stable, competitive marketplace with the ability to provide the insurance product at fair prices.

Finally, there appears to be an underlying presumption that passage of this proposed legislation will have a direct or indirect effect of reducing the cost of insurance to the consumer. We submit that passage of this legislation will not affect the cost of insurance in the aggregate. The services the professional casualty agent provides are essential to the management of his clients' needs. The agent's cost of doing business will be recouped. I submit that passage of this bill will, in fact, have precisely the opposite effect than intended. The insured, having large premiums and, therefore, relatively high economic clout, will use this as leverage to obtain a reduction in his insurance cost. The only alternative left for the agent will be to charge more of his other clients for his services. Therefore, the direct result of this legislation will be an increase in amount paid by the average American to subsidize the economic power wielded by larger corporate insureds.

In closing, we feel that this legislation seeks to resolve a non-existent problem and supercede state legislation which has been arrived at as the result of decades of state regulatory experience with a federal initiative which fails to consider the full spectrum of related issues.

Mr. LAFALCE. Thank you very much.

I will try to limit myself to 5 minutes.

Mr. Vogel, I just have to comment that when you were making the comparison between the insurance industry and the brokerage industry, you seemed to express utter dismay at the terrible state of affairs that has come about in the securities industry. I think that was your testimony.

It seems to me you ascribed all of the ills of the world—except perhaps the 150-point drop in the Dow Jones—and perhaps we can lay the blame for that, too, on this problem.

If you are having difficulty——

Mr. VOGEL. Page 9, I think you are referring to.

Mr. LAFALCE. Yes. It is page 9 that I am referring to.

Mr. Steinbach, you make so many points about how we have got to permit a little bit of gravy every now and then to make up for the contract where you really don't do so well.

It would seem to me to be a much more rational approach to have the fee match the product and service and the quality of the product, and the quality of the service, rather than to have distortions here and distortions here and proceed on the theory that the distortions will balance out.

It seems to me that is the theory that you are proceeding on.

You raise the point that gee, we shouldn't permit rebates.

It seems to me you are also arguing, at least implicitly, that it is impossible to determine the quality of the agent. If you go to one agent, you might make a determination based upon your overall impression.

Of course, if you don't shop around or go to different agents, you might not.

It could be you cannot make that type of comparison. Very often individuals don't. They just go to one person, the same as they go to one attorney or one doctor.

It is a defect in the system, to be sure, but it is not mandated by law.

At one point in time you mentioned attorneys, too, to the effective that attorneys were engaged in price fixing. They had minimum fee schedules. So if you would be considered ethical by your peers in the legal profession, you would have to charge a certain percentage on a real estate deal.

If the house sold for $25,000, you would have to charge, depending upon whether you were the seller or the purchaser, 1½ percent. If the house sold for $500,000, you would still proceed on that same percentage basis.

At least there wasn't a law mandating that you had to do it, but the code itself had the effect of encouraging that type of practice and then the Supreme Court said even that type of code, even though it doesn't have the sanction of law, is unconstitutional and cannot be permitted, and you have attorneys today charging on a percentage basis, charging a flat fee regardless of the amount of the house, charging not on a percentage basis, not on a flat fee, but on the basis of time.

And the individual can go to the attorney of his choice.

For some individuals, costs would be the primary consideration. For others, he won't be concerned about cost in the slightest. He may want to go to the largest firm, the most esteemed firm.

The whole point, it seems to me, is that this is something that ought not to be mandated by law. That is the essence of price fixing, the essence of regulation.

For example, I opposed the legislation that Congress passed this year which prohibited any surcharge by a retailer when a customer wants to use a credit card. I was only one of four Members of Congress. The banking community, which favored deregulation so much, wanted that type of regulation.

I thought basically it was anticonsumer. I didn't have much company.

I have also introduced legislation this year that would preempt State usury laws. The banks favor this type of deregulation, but they favored the regulation when it comes to the surcharge.

The reason I favored the preemption of the State usury laws is because I thought that the free market should work there.

So, you understand that my efforts along the lines here are not anti- or pro-agent. Some agents would make out an awful lot better if my bill were to pass, an awful lot better.

Some would not make out nearly as well.

So I suppose it is pro some and anti others in end result.

Well, it is my honest belief that it is proconsumer in the long run. It is also my awareness that reasonable men can differ, and I now call upon one of those reasonable men for his 5 minutes.

Dan?

Mr. MARRIOTT. Mr. Chairman, is that 5 minutes per witness or 5 minutes per total?

Mr. LAFALCE. Let's try to wrap it up at a quarter to four.

Mr. MARRIOTT. All of my questions have been under 5 minutes, but the answers have been longer. Does this include the answers?

Mr. LAFALCE. It includes the answers.

Why don't you wrap it up by a quarter to four?

Mr. MARRIOTT. Let me say, I appreciate the testimony given. I think it does give us a different perspective that we haven't had so far today. Somehow we have tried to argue that commissions are bad, but that fees are good.

I think this group ought to know that one fellow came and laid out all his credentials on the table. I, too, am a life member of the Million Dollar Round Table. I have sold millions of dollars of term insurance and ordinary life insurance. I have also worked on a straight fee basis where we did not even write the insurance. We did the consulting on the insurance and then somebody else wrote and got the commission to comply with State laws.

This business, that opening this up to rebating is good because it will be competitive, is just a lot of malarkey, in my opinion.

I speak as one who has been in the business for a number of years.

First of all, nobody worth his salt is going to rebate anything. If you are in the life insurance business and you are charging fees or you are given stated commissions, you are basically going to get what you earn.

I think the insurance industry is relatively aware of that. I don't know how the actuaries feel, but I think basically you figure it in these premiums to begin with, at what the industry considers to be a reasonable level of commissions for selling the product. I don't think that is price fixing at all.

So, whether you have a stated commission schedule, or whether you have a pure net cost insurance policy and you add your own fee, the consumer isn't going to benefit one iota in my opinion.

Insurance agents will end up selling on the basis of one gimmick or another. Term insurance salesmen can run out and get more commissions for selling term products, and so on and so on.

People can feel like professionals whether they are or not because they are charging a fee.

I guess that is pretty good for the salesman; but, my feeling is that nobody today has pointed out any benefit to the consumer.

We have used the consumer loosely but no one has shown how the consumer benefits.

We blasted commissions, we blasted insurance agents, we blasted ordinary life insurance. We have evaded the question of how we really help the consumer. I don't think the consumer gets helped at all.

I would just ask you one question in the 5 minutes that are left: Is there any way you see how going to a net commission, net policy, with an add-your-own commission as the market will bear concept, is going to protect the consumer at all? Can any of you?

Mr. VOGEL. No.

Mr. MARRIOTT. Do you see that at all?

Mr. VOGEL. No; I don't see that as helping the consumer. I think it would get the agent into the business of doing his own separate billing. It would be confusing. I can think of problems, like what

happens if the consumer buys a net policy with an add-on commission and decides to hell with the agent, I am just going to pay the net premium straight to the company.

I don't know how it would be policed. I think it would be a mistake. I would concede, however, that rather than rebating, going net plus add-on is sort of a clean way of doing what rebating does in a very complicated and messy way.

I think that the system we have now works better than either of them.

Mr. SCHEEL. I agree wholeheartedly without any further comment.

Mr. ALBUS. Insurance is a long-term product. I think it is important because it is such a desirable product, that individuals know what it costs. There has been a lot of comments today that agents sell certain products because they make more money, yet there is apparently an assumption if they added a service fee, it would always be reasonable.

Now, there are States, as Mr. Marriott pointed out, where you can now charge a service fee. Life agents can. There are some that can charge both a commission and a service fee although in some they are mutually exclusive.

The only requirement is that all agreements be in the contract. I think there has been a lot of discussion today that a contract of insurance is extremely difficult to understand. It is an amorphous promise to pay. Very few people read their contracts. Perhaps it is a question of public education in this regard. I don't know, but if a man doesn't have it in the contract where he can at least look at it, then you do not know what deals have been made.

Obviously the more successful agents with the more established practices or the ability to exist on reduced income can indeed eventually, especially in the smaller communities, create monopolies.

We feel the way insurance is currently priced is proper but if it is felt to be necessary to net price it, then put it in the contract.

I am not advocating net pricing by any means, but it could be done without additional legislation.

I do not think it would benefit the consumer at all. I think the exact opposite would result.

Mr. MARRIOTT. Thank you very much, Mr. Chairman. Maybe you could have a bill to put it in the record.

Mr. LAFALCE. Well, I don't think we would want to regulate the insurance industry to the extent we mandate what goes into and what doesn't go into the contract.

Gentlemen, I want to thank you very much for your testimony today and that will conclude today's hearings on this issue.

[Whereupon, at 3:40 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

[The following statements were submitted for insertion in the hearing record:]

PREPARED STATEMENT OF ALFRED LINCOLN SCHONFELD, C.L.U., AGENT EMERITUS, MUTUAL BENEFIT LIFE

I respectfully ask that you enter into the record of the Small Business Comm. my objections to any action that would legalize and permit rebating of commissions earned in the sale of life insurance by licensed life underwriters. In addition to my

objections, I respectfully request the privilege of rebutting Mr. Ralph Nader and Mrs. Susan Mitchell, Commissioner of Insurance of the State of Wisconsin, both of whom testified before this committee in person, as reported in the Business Section of the Washington Post.

I am Alfred Lincoln Schonfeld, C.L.U. I was licensed in New York State in October 1937 and contracted with Massachusetts Mutual Life Insurnce Company until 1949 except for over 3 years of service in the Army during World War II, with about 3 years in England and France. In 1948 I became a Chartered Life Underwriter, one of the few to pass all the examinations at one time. In 1949, I went to Northwestern Mutual and when the General Agent was fired, I moved over to Mutual Benefit in 1950 and I am retired and agent emeritus with Mutual Benefit to this day.

I have written on life insurance in the life underwriters' bulletin, Trusts and Estates magazine and on 5 September 1981, a two-page article for the National Underwriter, the gospel of the life insurance industry. I have lectured and taught life insurance.

Mr. Ralph Nader testified that if rebating commissions earned in the sale of life insurance were permitted there would be a saving to consumers of $2 billion a year. That is an awful lot of saving. But Mr. Nader could just as well have said $4 billion $8 billion. Nothing in the Washington Post indicated that he had substantiated or qualified his figure. But he was just as wrong at $2 billion as he would be at $4 billion or at $8 billion, or even at 2 cents. The Truth is that there is no savings at all.

If you have two sons and you take $5 from the wage earner to give to the younger unemployed brother, how can that be construed to be a savings? If the life underwriters rebate $2 billion to the buyers of life insurance, the buyers have had $2 billion returned them at the expense of the dedicated men and women who had earned the $2 billion. How is that saving?

When the dedicated life underwriters earn that $2 billion, it is subject to income taxation. Should they rebate that money if such action is ever made legally permissible, God forbid, that $2 billion becomes an expense of doing business and will be subject to tax deduction on the income tax forms of the life underwriters. The life underwriters will not pay income tax on the $2 billion. In the hands of the consumers, that money is not subject to income tax in the first place. It is not income. It is a reduction of the cost of a service.

If a lawyer bills his client $10,000 and to appease his client reduces the fee to $7,500, that $2,500 reduction is not taxable income. If your automobile dealer gives you a $1,000 reduction from his marked selling price, you pay no income tax on the $1,000 you saved.

At best, Mr. Nader is adding to the taxpayers' burden by reducing taxable income.

I have thought about it and about, as Omar Khayyam would say, since I saw it reported in the Washington Post. How does the rebating that Mr. Nader and Mrs. Mitchell advocate differ from common bribing? The rebate cannot be made until after the transaction has been completed and the life underwriter has been paid the commission he had earned. He has entered into a cabal that if the buyer will consummate the transaction, he will rebate so many dollars. How is this different from a bribe?

If a Congressman should say to a voter, "If I am elected, I will rebate to you $250 for having voted me into office," how does that differ in ethics from the life underwriter who will make his rebate under the same circumstances?

The rebate is not from the life insurance company but from the earnings of the life underwriter after the completion of the transaction. Therefore, there will be a variance in cost from one person to another for the identical service. That is a situation that the life insurance industry has avoided in its long history.

The life insurance industry has stood for fairness and its keynote has been the same rate to each person of the same qualifications. Mr. Ronald Reagan at 70 would pay exactly the same rate as Mr. Pauper at 70 under the same medical conditions and the same size policy. Rebating destroys that great moral backbone in life insurance.

Competition? Competition does not have to be price. There is greater competition in life insurance now that price could ever foster. It is the competition of ideas and innovation and quality of service.

I don't remember the quotation but John Ruskin said that he who buys price is the dupe of his own ignorance.

Life insurance is not sold on price. In my 44 years, I have never had a beneficiary ask how much the life insurance had cost as he or she accepted the proceeds check. Never! The only thing that matters is will a check be handed to my beloved wife

soon after my death? Nobody cares whether these proceeds which I now hold in my had cost $32.04 for each $1,000 or $36.98 for each $1,000. It does not matter a whit.

Nor did it matter to the deceased insured because he would not give up his policy no matter what you offered him cheaper. When you make price the issue in competition in life insurance, you develop the procrastinators who spend a lifetime with a sharp pencil and die before they can get their hands in a pen to sign an application. A man buys life insurance because he realizes his economic responsibility, not because he can get it cheaply. A man does not turn down an offer of a policy because the rate is $28.74 but only when the love for himself is greater than the love he professes for others and he wants to use the money for himself rather than to protect those whom he professes to love and care about. Never price.

Mrs. Mitchell took issue with me in her letter to me, and probably in her testimony. But, then, Mrs. Mitchell is what we used to call in the Army, "chairborne" whereas I have been a warrior in the field of action for 44 years, armed with pen, ratebook, and applications. How is she qualified to tell me what the battlefield is like? She is philosophizing without 2 minutes experience against my 44 years on the battleline.

In his "Wind, Sand, and Stars," Antoine St. Exupery writes, "Truth is not that which is demonstrable; it is that which is ineluctable," In her letter to me, Mrs. Mitchell writes of identical policy at a lower cost. Putting aside for the nonce the question, "What is lower cost?" let me state here that in my 44 years I have never seen identical policies. If price were the only consideration for goods or services, no one would buy cadillacs or continentals. Men are willing to pay for uniqueness and who is to gainsay them that right.

What is cost? A few cents cheaper the first year? The underwriter is not expected to rebate in the second and subsequent years. The whole issue rests on the denial of income to dedicated people who have earned that income so that some people may get an insignificant break in the first year. It surely would be a great gimmick for those who sell costly life insurance for they could make it appear through rebate in the first year that they have low cost insurance. As Meletus accused Socrates, they could make the worse cause appear the better.

To Mrs. Mitchell, she had a cause to espouse which may raise the Insurance Department of the State of Wisconsin out of anonymity.

Rebating is strictly a rich man's benefit. In my experience it is not profitable to me to write a policy of less than $250,000. Under the base of $25,000 the commission in dollars and cents is negligible for the skill and work involved and under $25,000 is where all the people that Mr. Nader cries for are to be found. Does the man who buys $100,000 or $25,000 policy need any part of the life underwriter's earning? Are these the people that Mr. Nader and Mrs. Mitchell are worried for? The man under $25,000 can use some of the cash but the life underwriter can not sensibly give him any. The underwriter will lose his own money.

I had a case pending while I was switching from Northwestern Mutual to Mutual Benefit Life. I asked my general agent at Northwestern what he wanted me to do about this case. He appreciated my loyalty but he told me to take the case to Mutual Benefit. He did not need his overwrite.

I went to the prospective client and told him that I was making a change to Mutual Benefit. He said, "I suppose you are going to tell me now that Mutual Benefit is cheaper than Northwestern?"

I replied, "No, I am not. Northwestern has been the lowest cost company for the past 75 years or so and will probably be the lowest cost company for the next 75 years but let me show what Mutual Benefit gives you for the slight difference in cost."

Spontaneously, he stopped me. "Forget it. If you think Mutual Benefit is good enough for you to represent them, Mutual Benefit is good enough for me. What can the difference in cost be anyway?"

When the more than $300,000 in checks were delivered to his wife and children, nobody asked whether Northwestern would have been cheaper.

That is how life insurance is bought. Price plays no part in it, my 44 years in the frontline against a chairborne contemplation of what it should be.

Legalized rebating will remove the last vestige of dignity that life underwriters have. They are competent, learned, dedicated people except for the promoters, many of whom are throught to be rebaters. Yet the public looks upon these fine people as salesmen in the most pejorative definition. A life underwriter is a hero to his client only when he is being compared to his friend's underwriter, or contrasted. Then his client brags that he has the lesser of two evils.

Take away the restrictions on rebating and what ethic is left? If a man may sell without restrictions, why mandate that he be licensed? What authority can Insurance Commissioners like Mrs. Mitchell have over them if the rules are abrogated?

Life insurance will be denigrated to a peddler's commodity. At present, turnover of personnel is very high. The attrition by retirement and death of agents is not being filled in by recruits. Take away the last vestige of dignity and that will be the death knell of professionalism to the great damage and hurt of the consumer public.

Comparisons are offered with stock brokers and the varying schedules of fees. These comparisons are most specious. The stock brokerage firms set the commission rates not the individual brokers. The life underwriter has to sell at the rates set by the life insurance company and that is as it should be.

I do my stock brokerage business with Shearson. I don't know what the schedule of commissions is. I don't care. I am concerned with the care my broker uses in handling my portfolio.

I am a licensed registered representative with Independent Financial Planners Corp., Parsippany, N.J. I have been a registered representative since 1955. I have never asked a broker for one cent or more in rebate and I never investigated whether as a registered representative I may be allowed to split commissions. I don't know! What's more, I don't care! If I may legally ask for a cut in the commission because I am a licensed registered representative, I would be just as morally wrong because my broker earned the commission by handling the transaction for me.

Some years ago, a prospective client was about to sign an application for at least $100,000. He turned to me and said, "I want you to put my broker's name on the application."

I quietly and surreptitiously started gathering together all my papers on this case. I asked him, "You mean you want to do something for him?

He said, "Yes."

I responded, "That's very noble and nice of you. I wish the people I do business with would think of me that way but * * * if you want to do something for your agent, I suggest that you reach into your pocket and do something because if you buy this plan, the commission is mine and I won't share it with your agent or anybody else. I have no reason to do anything for him. You have, you do it."

All the papers went into my bag and I tossed up the case like a feather in the wind. That is the true recognition of a commission. If he bought, I earned the commission. From the moment he bought, it was my money. I had earned it. I had offered him value for his money. It was his choice. He did say to me that he didn't think his agent could work up a plan as I had done.

There is no sound reason to permit rebating. It is demoralizing. It is degrading. It despoils the rebater of any shred of self-esteem. Why should a life underwriter expect $1,000 from the life insurance company if he is not worth it and if he is worth it, why should he share it with any stranger? There cannot be a rebate until the underwriter had earned the money. He shares what is his when he rebates. I cannot think of it as anything less than a common bribe.

Postscript: As I read the ads of the discount stock brokers, there appears to be the hidden advice that you get your advice and information and then buy from them. That is hardly the moral atmosphere that I would condone. I would not hesitate to accuse anyone who took or takes my ideas to his agent for implementation of outright stealing.

INDEPENDENT INSURANCE AGENTS OF AMERICA, INC.,
Washington, D.C., September 21, 1981.

Hon. JOHN J. LAFALCE,
Chairman, Subcommittee on General Oversight,
U.S. House of Representatives, Washington, D.C.

DEAR REPRESENTATIVE LAFALCE: The Independent Insurance Agents of America is a national trade association of 35,000 member insurance agencies, 126,000 licensed insurance agents, and over 200,000 employees in every state and the District of Columbia.

We strongly oppose your proposed legislation to repeal existing state anti-rebate laws, request that this letter be included in your subcommittee's hearing record on the bill, and would appreciate an opportunity at a later date to submit a more detailed statement.

Briefly, there appears to be little justification for a proposal of such dramatic and uncertain implications as the summary repeal of state anti-rebate laws.

Just last year, in connection with proscribing the Federal Trade Commission's authority to investigate certain insurance activities, Congress re-affirmed the validity and desirability of the McCarran-Ferguson Act and its explicit bias in favor of state regulation of insurance.

Today, all 50 states have anti-rebate laws on their books, the result of deliberate decisions by individual state legislatures reflecting the collective wisdom of the separate states that anti-rebate laws achieve desirable, reasonable public policy goals. These collective conclusions should not be uniformly nullified by federal law.

Insurance today is highly competitive in terms of price, product, and service. This is not only statistically demonstrable in terms of steadily decreasing premium costs over time, but is readily apparent to anyone who has recently shopped for insurance coverages and sampled the competition that today defines the insurance market. Numerous outlets, ease of entry, and opportunity to apply entreprenurial skills to achieve economic success are the hallmarks of today's insurance market, and every day bring to insurance customers the tangible, real-life benefits of competition.

Conversely, there is no evidence (only academic theory and conjecture) that state anti-rebate laws have made competition in insurance less than it might be without such laws, and some reason to believe that competition and service might be reduced if anti-rebate laws were removed from the books.

Enacted around the turn of the century to bring stability and fair business practices to a tumultuous insurance market, anti-rebate laws today continue to serve those laudable purposes. Discrimination among insurance clients, higher prices, concentration of outlets, and fraudulent or fast-buck oriented business practices could be expected, by varying degrees, to result from the precipitous repeal of anti-rebate laws.

"Price fixing", and "monopoly pricing" are terms used to describe anti-rebate laws in remarks that accompanied introduction of the Insurance Sales Deregulation Act of 1981. That is neither their purpose nor effect. Insurance anti-rebate laws—like the Davis Bacon Act, collectively bargained labor contracts, and minimum wage laws, to name just three—are one of many examples of deliberate public policy decisions designed to moderate market behavior in ways intended to preserve stability, service, and fair business practices. As such, they should not be altered lightly or with impunity, nor pursued outsie the domain of clearly established state legislative authority.

Sincerely,

ROGER N. LEVY,
Director of Legislative Affairs.

NATIONAL ASSOCIATION OF LIFE COMPANIES,
Atlanta, Ga., October 19, 1981.

OVERSIGHT SUBCOMMITTEE,
COMMITTEE ON SMALL BUSINESS,
U.S. House of Representatives, Washington, D.C.

GENTLEMEN: On September 21 the House Small Business Oversight Subcommittee held a hearing on Representative LaFalce's bill entitled "The Insurance Sales Deregulation Act".

According to our understanding, there was only a four-day general notice given, but no actual or constructive notice was given to the National Association of Life Companies. We are aware of Representative LaFalce's repeated efforts to move the Federal Government more deeply into insurance and feel that his new efforts in the name of "consumerism" only cloak a closeted desire to have the Federal Government regulate the insurance industry.

The NALC represents approximately 250 life insurance companies, most of which are small and medium-sized companies, and on which the effect of the proposed legislation would be much more severe than it would be on the large giants. The Board of Directors of the National Association of Life Companies met in Washington on September 22, and after reviewing the provisions of H.R. 4497 and the newspaper accounts of the hearings, voted unanimously to oppose the legislation and to make our position known "through all appropriate means".

It is rather ironic that your Subcommittee falls under the jurisdiction of the Committee on Small Business, and yet the small life companies which would be affected most by the legislation were not consulted. In case you are not aware of the existence of the NALC, we are enclosing a booklet outlining the work of our association and also a Directory of our Membership.

The NALC agrees with the testimony given by William N. Albus, of the National Association of Life Underwriters, that the repeal of the anti-rebate laws would: (1) wreak havoc with intents to design an effective, accurate cost comparison of policies

by making such disclosures meaningless; (2) encourage lapses because agents would be able to offer the largest reductions on first-year premiums; (3) increase agent turnover since most well established agents would be in a superior position to offer better discounts; (4) produce unfair discrimination among purchasers of life insurance as where larger volume buyers could use their leverage to demand better rebates than small volume buyers could obtain. We also agree with the testimony given to the effect that life insurance must be distinguished from other consumer products where rebates are permitted. Life insurance is a purchase of a benefit realized in the future which requires ongoing payments and not simply the receipt of a sales slip showing the price paid.

The NALC would like to add its voice in opposition to H.R. 4496 not only for the above reasons but because it feels that rebating would lead to long-term declining competition by maintaining the dominance of the larger companies and agencies and thereby unduly harming the role of the small and medium-sized life insurance companies.

We would appreciate your making note of our opposition and giving us ample notice for any additional hearings that you propose on this legislation.

Very truly yours,

S. ROY WOODALL, Jr.,
Executive Vice President.

AMERICAN INSURANCE ASSOCIATION,
FEDERAL AFFAIRS DEPARTMENT,
Washington, D.C., October 1, 1981.

Hon. JOHN J. LAFALCE,
Chairman, Committee on Small Business, Subcommittee on General Oversight, U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Thank you for your letter of October 2 inviting us to comment on H.R. 4497, the Insurance Sales Deregulation Act of 1981.

The American Insurance Association is composed of about 150 publicly held insurers writing all lines of property and casualty insurance in the fifty states. The aggregate premium in force for the AIA companies is about $28,515,106,800.

We have reviewed H.R. 4497 along with your remarks on the day of its introduction and have examined statements of witnesses who testified before your subcommittee on September 21. The Association does not concur with your evaluation that "the current broad exclusion from the antitrust laws afforded the insurance industry has severely weakened competition and has had a severe adverse impact upon the interests of consumers of insurance." [1] On the contrary, the Association supports the McCarran-Ferguson Act believing that it does not weaken competition and is opposed to the amendments to that Act which you propose as H.R. 4497.

Your bill would nullify the decision independently arrived at by the legislatures of the fifty states to outlaw the rebating of commission by insurance agents.

We believe as a matter of policy that determinations of this nature ought to be made in the states. In fact, when Wisconsin Commissioner Mitchell, who testified before your Subcommittee in support of H.R. 4497, proposed legislation to end anti-rebating practices in her state, our Association did not oppose her efforts.

Turning to the substance of H.R. 4497, we remain unpersuaded that anti-rebate statues are per se "costly and enduring price fixing schemes" as you described them in your opening statement. The analogy you draw between these laws and so called "Fair Trade" laws is inaccurate. On this point we concur with the distinction drawn by the witness representing American Council of Life Insurance.[2] The ACLI presentation is also helpful in putting the anti-rebate laws into the appropriate historical perspective. We are also convinced that your bill would amount to "legislative overkill," going much further than its stated purposes and seriously weakening effective state regulation.

In summary, the Association is convinced that any legislative inquiry into insurance agents' compensation is appropriately the province of the several states. We are unaware of any inequities which derive from these laws and should any develop, we are confident that the states' insurance regulatory framework would be responsive. The Association's general policy is one of support for the McCarran-Ferguson Act. This position is in harmony with our opposition to H.R. 4497 and our consistent

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[1] H.R. 4497, 97th Cong. 1st Sess. § 2(a)(1).

[2] Statement of the American Council of Life Insurance to the Subcommittee on General Oversight of the Committee on Small Business, U.S. House of Representatives, September 21, 1981.

record of support for price competition and rate deregulation to which you refer in your letter to me.

I trust this information is responsive to your request.

With highest personal regards, I am

Respectfully,

WILLIAM W. SUTTLE,
Vice President, Federal Affairs.

PREPARED STATEMENT OF THE NATIONAL ASSOCIATION OF INSURANCE BROKERS

This statement on H.R. 4497, "Insurance Sales Deregulation Act of 1981," is submitted pursuant to a request by the subcommittee chairman that the National Association of Insurance Brokers (NAIB) provide comments for the hearing record.

NAIB represents approximately 125 commercial lines insurance brokers throughout the country. Our membership includes the largest national (and international) insurance brokerage firms, as well as firms whose operations are local or regional in scope. Our members provide insurance and risk management products and services to a wide range of businesses; such services include placement of insurance programs with commercial insurers, management of self-insurance programs and captive insurers, risk management and consulting services.

It is important that the subcommittee understand our perspective as we address H.R. 4497, since our focus is markedly different from that of the sponsor of the bill. Our focus is on the marketing of commercial lines of property and casualty insurance, and employee benefit programs, to business clients. The focus of the bill's sponsor, as evidenced by remarks in the floor statement upon introduction of the bill (Congressional Record of 9/16/81, pp. H6320-1), appears to be on the sale of life insurance products to individual consumers.

From our perspective, it is impossible to accept the bill's basic premise that there is insufficient competition in our business. With several thousand insurers and tens of thousands of agents and brokers competing aggressively, the insurance market is extremely competitive. At the present time, with record-high interest rates supporting investment income, insurance price competition is more severe than at any time within memory, and price slashing is the order of the day. It is difficult to believe that with "additional competition" between insurance producers, premiums to policy holders would be effectively lowered beyond the levels one finds today.

From our perspective, also, the state laws which H.R. 4497 would prohibit (the so-called "anti-rebate" statutes) have little practical impact on our business. As brokers, our members represent the client and may approach the market through a number of insurers in order to place that client's insurance program. Since broker commissions are individually negotiated, the opportunity is already afforded with each placement to negotiate a commission which will produce a premium sufficiently attractive to obtain the client's business and cover the cost of servicing the account.

Our members may also represent some insurers under agency agreements, and in these instances, operate in the same manner as independent agents. Even though the agency agreements contain commission schedules, however, it is not unusual for the agent or broker to accept less than the specified commission for a particular account in order to obtain the premium necessary to attract and keep the client. Such conduct is not violative of the state "antirebate" statutes since the negotiations to achieve a reduced premium for the client occur between the insurer and the agent or broker before the premium shown on the policy is finalized, and therefore, does not constitute the offering of a benefit not specified in the policy. The practical effect to the client is that he receives the insurance product/service package at a commission schedule or for a negotiated fee set competitively by market forces. This occurs without the dangers inherent in a system which permits the offering of rebates and other benefits to prospective clients as an inducement to purchase the policy.

While we would grant that commission negotiation does not play as prominent a role in the determination of final prices for the personal lines of property and casualty insurance or for individually marketed life insurance, we would caution the subcommittee against embracing rebating as a means of promoting greater competition in those segments of the industry. The subcommittee heard testimony on September 21, 1981 from the American Council on Life Insurance, the National Association of Life Underwriters and the Professional Insurance Agents, detailing the adverse results which are likely to be produced by a preemption of the state "antirebate" laws. We believe that their arguments concerning the discriminatory

impact on individual insureds have merit and should be carefully considered by the subcommittee.

NAIB is a firm believer in competition in the insurance industry. While we have supported deregulatory proposals at both the state and federal level, we have done so in the context of the existing system of state insurance regulation, and we continue to support that system. The states are the proper arena for a consideration of whether the "anti-rebate" statutes should be continued, since there they will be considered in the context of the rate regulatory laws and trade practices laws which govern the pricing and marketing of insurance policies. While NAIB has taken no position on "antirebate" statutes, we do support the right of the states to determine whether such statutes are warranted in their jurisdictions. Consequently, we must go on record as opposing enactment of H.R. 4497.

PREPARED STATEMENT OF THE NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

The National Association of Independent Insurers (N.A.I.I.) is a voluntary insurance trade association which represents 500 property and casualty insurance companies of all types—stocks, mutuals, reciprocals and Lloyds. They reflect all forms of merchandising—independent agency, exlusive agency, direct writing and direct mail.

H.R. 4497 would amend the McCarran-Ferguson Act to invalidate laws in all 50 states which prohibit agents from offering special inducements to prospective insureds which are not specified in the insurance contract (policy) delivered to the insured. These inducements are known as rebates. The N.A.I.I. opposes H.R. 4497 because we oppose vigorously any direct or indirect amendment of the McCarran-Ferguson Act, the law that provides responsibility for insurance regulation at the state level.

The chairman of your committee has written for our comments with particular regard to our historical position on rate deregulation. Because this request dovetails closely our position with regard to state regulation of the insurance business, we will focus our comments on that.

The N.A.I.I. since its inception has supported state regulation of insurance, in those areas granted by the federal exemption as a best effective mechanism for protection of the public and insurers in this very personal and demographically variable service product. Just last year over 34 years after the McCarran Act has passed, Congress in its deliberations of the Federal Trade Commission Authorization Act in 1980, reaffirmed that it was in the public interest for the states, not the Federal government, to continue to regulate the insurance business.

Aggressive competition provided by property and casualty companies has benefited the consumer in the form of the rate savings provided directly through the impact such competition has had on premium charges and new and innovative products. Vigorous market forces have, for example, motivated companies to reduce expenses. The average expense portion of the automobile insurance premium dollar for all stock companies dropped from 42 cents in 1943 to about 26 cents currently, a reduction of about 38 percent. This, of course, provided cost savings that are passed on to policyholders in the form of premium reductions.

Vigorous competition in pricing has been matched by equally aggressive competition and innovation in products and services. Insurance coverages have been continuously broadened and improved as companies have vied to better meet the changing demands of the consumer. Companies and producers are likewise constantly vying to find better ways to serve the special needs of their particular customers, and thereby increase their market shares. All these characteristics typify a highly competitive industry.

Another classical economic measure is market concentration. Property/casualty insurance is one of the few industries which can truly be labeled fragmented. There are more than 2900 licensed property/casualty insurers in the United States. Although many do business in only one state, about 900 operate in all or several states.

Numerous studies have documented that the concentration ratio in our business is quite low as compared to most other industries. The largest writer of property/casualty insurance in the country has about 8 percent of the market, and the top 20 groups account for less than 55 percent of the market.

Ease of entry by new entrepreneurs is also recognized by economists as a key element in the existence and maintenance of a competitive market. Here again, numerous studies agree that entry into property/casualty insurance market has been relatively easy, that there has been a healthy influx of new companies in recent decades (336 new companies entered the market between 1960 and 1971), and

that those periods when the influx has slowed are attributable to dips in profitability rather than to entry barriers.

Profitability is another test of competitiveness. If overall profits were found to be inordinately high, it could indicate that there has been a dearth of competition which has permitted maintenance of artifically high price levels. Exactly the opposite is the case here: the profit record of property/casualty companies as a whole, when tested by any of the various measurement formulae applied by competent economists, has remained well below that of other industries in our economy, reflecting in large part the impact of competition.

In spite of below par earnings, our industry has managed to provide the increased capacity required to meet the expanding insurance needs of a rapidly growing population. This fact denotes that our business is not only competitive and progressive, but highly efficient as well.

In sum, the case for continued state jurisdiction over all aspects of the property/casualty insurance business including ratemaking is infinitely stronger than it was 35 years ago. The states have responded comprehensively and meaningfully to the McCarran Act challenge to "regulate." Our business, operating within the framework of that comprehensive regulation, has emerged as an industry which surpasses most others (including most industries now subject to the antitrust laws) when measured by the classic tests of nonconcentration, ease of entry, and absence of excessive profitability. At the same time, it has been meeting its responsibilities in the marketplace by expanding overall capacity, affording a broad choice of prices, products and services for the consumer, and jointly guaranteeing availability of insurance to all consumers who cannot readily obtain it in the voluntary market.

The chairman in his reference to our consistent record of support for rate deregulation, must know that the idea of a fully deregulating property and casualty insurance from all controls (both at the minimum and maximum levels) and operating purely under the antitrust laws is an intriguing fantasy for us. However, any such proposal must carefully consider the fundamental question as to what form of regulatory system best fits the unique insurance operation and best serves and protects the interests of the insuring public in all subject areas involving insurance—including price, product, market availability, and solvency. After consideration of all these matters we conclude that:

While rate competition is indeed a prime regulatory tool, it would not serve the interests of the public to eliminate all state rate regulatory authority and place total reliance upon unrestricted competition under an antitrust system.

The antitrust laws and the procedures and apparatus for enforcement of those laws are not well suited for broad-scale application to property/casualty insurance. Attempting to so apply them would disrupt certain normal, necessary insurance operations, create massive market problems, and impair the ability of many companies to compete.

State open-competition rating laws are much better mechanisms than the federal antitrust laws for assuring insurance consumers the benefits of price competition while serving their other interests and needs.

State prior approval rating laws, while not procedurally "ideal" do provide broad avenues for competition and are more suitable mechanisms than the federal antitrust laws for dealing with the property/casualty insurance ratemaking function.

For these reasons, we conclude that even where the legislative program to be proposed to the Congress is one of true deregulation and pure antitrust theory, it would still constitute neither a workable nor desirable approach to insurance ratemaking. Our political judgment solidifies this conclusion. Indeed, we feel that the probable ultimate outcome of any reopening of the McCarran Act will not be less regulation but more regulation—the superimposing of onerous federal controls on existing state controls.

The 50 state statutes against rebating are designed to secure to all persons equality as to burdens imposed, as well as to benefits derived by preventing discrimination by insurers in favor of individuals of the same class, either as to premiums charged or dividends allowed. Prospective insureds of the same class should not be unfairly treated or discriminated against, by inducements given to one of such class which are not available to all in the same class. Anti-rebating statutes prevent discrimination between insureds of the same class. At this point one might conclude these statutes strike out at the mere sharing of the commission by an agent or producer. Previous testimony of some of the proponents would indicate this misconception. Anti-rebating laws extend not only to premiums charged and dividends to policyholders, but include special services, loans on policies, extension of time, predating of policies and added benefits. In spite of these reasons for such laws, state regulators are constantly reviewing the justification for these laws. We believe the

record is clear that the proper place for the consideration of the issues raised here is at the state level.

Even though the Small Business Committee does not have jurisdiction over H.R. 4497, we thank the Oversight Subcommittee for this opportunity to comment on the bill and reiterate our opposition to H.R. 4497.

ALLIANCE OF AMERICAN INSURERS,
Washington, D.C., October 30, 1981.

Hon. JOHN J. LAFALCE,
Chairman, Subcommittee on General Oversight, Committee on Small Business, U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Your letter of October 23, 1981, requesting our views of H.R. 4497 was not received, for some unknown reason, until late October 28th. Since you have requested our views by November 2nd, we will not be able to give the issue the extensive treatment we otherwise would have, had we had more time.

We had not requested time to testify on H.R. 4497 before your subcommittee since we had planned to testify extensively before the Judiciary Committee, if and when that Committee holds hearings on the legislation. We still intend to do so even though we are providing you with these views at this time.

H.R. 4497 would not reduce overall insurance costs, as some of the witnesses have testified to before your subcommittee. The effect of the legislation would be to redistribute costs so as to allow insurance purchasers with political, financial, social or other clout to secure concessions from agents. These agents, in turn, could offset those concessions by raising insurance premiums to those devoid of such influence. The legislation would lead to unfair discrimination between similar policyholders. The Alliance opposes unfair discrimination and hence opposes the legislation.

There are those who testified before your subcommittee that H.R. 4497 would "stimulate competition" in the insurance industry. The fact is, however, that insurance is recognized today as one of this country's most competitive economic activities already. Aggressive competition is carried out in the marketplace, where consumers have wide options to select purchasing channels which best fit their needs and pocketbooks. The mix between the agency system, brokers, direct mail or company agents offers the insurance buyers an unlimited field of options, while strict regulation of insurance by the states protects the insurance buyer against unfair discrimination.

H.R. 4497 would not further promote competition in an already-competitive industry. It would subvert the crucial regulatory objective to prohibit unfair discrimination. It would not reduce costs.

For these reasons, Mr. Chairman, we plan to oppose the legislation before the House Judiciary Committee.

Thank you for having invited us to present our views.

Sincerely,

ANDRE MAISONPIERRE.

INSURANCE WORKERS INTERNATIONAL UNION, AFL-CIO,
Washington, D.C., November 3, 1981.

Hon. JOHN J. LAFALCE,
House of Representatives, Washington, D.C.

DEAR SIR: We had written to you on October 20, 1981 regarding H.R. 4497. In that letter, among other things, we informed you that we were unable to appear at the hearing you held on this Bill because we were tied up in negotiating a new agreement for the 16,500 Prudential insurance agents we represent.

We have had the opportunity to speak to some of your people about the Bill, and as a result feel it is necessary to make our position clear.

We are submitting a position statement and would appreciate your making this statement part of the record of the hearing which you held on this Bill.

We would still welcome the opportunity to discuss this matter with you at your convenience.

Sincerely yours,

JOSEPH POLLACK, *President.*

Enclosure.

STATEMENT BY JOSEPH POLLACK, PRESIDENT, INSURANCE WORKERS INTERNATIONAL UNION, AFL-CIO

H.R. 4497 clearly states its objective. It seeks to: "improve the operation of competition in the business of insurance." It seeks to accomplish this by legalizing rebating to an unlimited degree. The practice of "rebating commissions" is actually what the objective of this Bill is. The practice of rebating was one of the evils which was uncovered in 1905 and which every state in the nation saw fit to outlaw.

The use of the buzz word, "free trade" is the banner under which this Bill hopes to fly. The logic of the uneducated theory that, by forcing insurance agents to return to the client a portion of their earned commissions, or even "benefits" which far exceed their commission, this will in some way lower the price of insurance or encourage competition, is to say the least ludicrous. The life insurance business is probably one of the most competitive in the nation. At the end of 1980 there were 1,948 insurance companies in the United States, and this does not include fraternal benefit societies and companies which are chartered and licensed but are not actively in business. The competition among these companies for the insurance dollar is fierce and over the years has effectively resulted in sizeable decrease in premiums for the same policies.

However, H.R. 4497, while it claims to seek to improve "competition in the business of insurance," does absolutely nothing in terms of attempting to regulate insurance companies but instead offers the ridiculous solution to the problem by the simple expedient of forcing insurance agents to pay back their commissions in one form or another to the buyer. This approach demonstrates conclusively that the Bill is based on total ignorance of the Insurance Industry and the actual function of an insurance agent. Our Union represents the insurance agents of over 20 insurance companies in the United States. All of these agents are employees of their company and are covered by the Labor-Management Act. None of these insurance agents has anything to do with the setting of premiums for various classes of insurance. The great majority of these agents as employees are restricted from selling any type of insurance for any company other than their employer. There is no way that the agent can have any effect on the premium for a particular policy offered for sale by his employer, and his contract forbids him to sell policies for any other employer.

The only accomplishment passage of this Bill would compel is that the agent would have to share his commission or an amount in excess of his commission with the purchaser. Insurance companies operating in the State of New York must agree to comply with that state's insurance laws in their entire operation. New York State insurance laws set forth definite limits on the amount of commission and other expenses a company can pay out. The highest rate of commission that any agent can receive is 55 percent first year commission. This is not true of insurance companies that do not operate in New York State. They are free to pay whatever rate of commission the market place may dictate. If this Bill were to become law, every life insurance company would have to stop operating in the State of New York, so that they could pay higher commissions so that their Agents could rebate higher amounts. The inconsistency of this irresponsible proposed legislation is that the rebate would apply only to the first year of the policy—that is, the amount of the premium would not change, and the agent would not have commissions such as his first year commissions to rebate to the policyowner.

All that can be accomplished by this Bill and the only competition it would encourage is as to how much an agent could offer the prospective buyer of that agent's commissions and still remain in the business of selling insurance. Life insurance must be sold, most people do not have the purchase of life insurance high on their shopping list of items they must have. In three states, savings banks sell life insurance; they advertise, they have personnel in the bank who specialize in the sale of life insurance, and they continually run campaigns to encourage the public to purchase their life insurance from them. They constantly solicit their depositors, pointing out that the premiums are lower because no agent is involved in the sale. During 1980 the savings banks in the State of New York sold $615,000,000 in the same year. In the same state, life insurance companies sold $24,080,000,000. In the State of Massachusetts the savings banks sold $496,000,000, and insurance companies sold $6,813,000,000. In the State of Connecticut, the third state where savings banks life insurance is sold, the savings banks sold $118,000,000 and the insurance companies sold $5,641,000,000. While there are limitations on the amounts of insurance the savings banks can sell to one person, the limits in New York, Massachusetts and Connecticut far exceed the amount of the average policy sold in 1980. There is no question that experience gained from record keeping and performance shows that life insurance has to be sold. It has to be sold by agents who are trained and who are willing to make any number of calls at homes and offices in order to create one prospect, who then has to be sold.

Nearly all of an agent's compensation is based on the policies he sells. If this Bill were permitted to become law and an agent would be forced to return all or part of his hard-earned commission, there would be very few life insurance agents in America and even then the few that would remain would never be replaced, because no one would study for or aspire to enter a profession where at best you could only earn very little compensation.

Passage of this Bill would be critically damaging to the economy. Life insurance companies in 1980 had $33,015,000,000 worth of government securities, and $131,080,000,000 in mortgages. It would cause every life insurance company to flee from the State of New York; and it would cause losses of jobs in an industry which now employs 1,895,000 persons in all branches of the industry, with 740,000 in life insurance. Passage of this Bill would create a jungle where companies would in desperation hire unqualified part-time people, who would as a side-line sell life insurance when they could get a client to whom they didn't have to return their commissions. The damage to the public's insurance estate would result in grief and tragedy to the American public. Heads of families would be uninsured because there would be no one willing to spend hours and even days trying to convince the head of the household of the need for life insurance. Presumably the undertaking industry would be forced into the "rebate" philosophy as widows and orphans attempt to scrape up a few dollars and get the best deal possible to put Daddy in his final resting place.

It is not the purpose of this statement to defend the insurance industry. That industry, with all of their talent and all of their worth, is perfectly capable of defending themselves if this becomes necessary.

Our Union has spent all of its existence fighting for and protecting insurance agents from unfair treatment by the insurance companies. Our members have been forced to strike insurance companies in an effort to gain a fair share of the fruits of their labor and fair treatment. Our Union spends its assets on negotiating rates of commissions for its members, as well as working conditions and fringe benefits. This Bill would completely destroy any effect of negotiations and would eliminate the value of any negotiations. It would make a mockery of negotiating a first year commission rate when in fact the agent would be returning to the policyowner a portion, or all, of the commission. Our Union has for over 40 years been the spokesman for thousands of insurance agents throughout the entire United States. Our members have always been dedicated, serious students of life insurance and have served the public well. Agents such as those we represent introduced life insurance in this nation. They made it possible for working people to have life insurance by calling at their homes to collect the premiums, weekly if necessary. They braved the elements and worked hard and long to establish in this nation what is now the powerful insurance industry. Those who followed them carried on the same traditions, they were a friend to every family in their territory. We are not talking about fast buck hustlers who are cheating the public and now need some federal law to force them to give away their commissions in order to sell life insurance.

We oppose this Bill for all of the reasons set forth in this statement, and we would advise the persons who wrote and introduced this atrocity that in the future they consider what they are dealing with prior to introducing legislation which purports to have an objective which it comes nowhere near dealing with. Our Union is not opposed to efforts to protect the consumer. Our record over the years attests to that. Our Union is opposed to foolish and misleading efforts to encourage irresponsible law under the guise of consumerism.

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